Office Supreme Court, U. S.
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CHARLES ELMORE CROPLEY
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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1927.

No. [redacted] 1

UNITED FUEL GAS COMPANY AND WARFIELD NATURAL GAS COMPANY,

Appellants,

vs.

THE RAILROAD COMMISSION OF KENTUCKY, FRANK N. BURNS, OSCAR VEST and ISAAC WILDER, members of and constituting said The Railroad Commission of Kentucky, and FRANK E. DAUGHERTY, Attorney General of the State of Kentucky.

Appellees.

BRIEF ON BEHALF OF APPELLANTS.

JOHN W. DAVIS,
S. S. WILLIS,
HAROLD A. RITZ,
DOUGLAS M. MOFFAT,
EDWARD L. PATTERSON,
Counsel for Appellants.

Ky Case. Suit brought by United Fuel Gas Co v Marfield Natural Gas Co - Former Ky Corp. Latter Ky Corp. franchises of former to serve Grally in Ashland Catlettsburg & various others - Act of Mch 2 requires Co Whose franchises have expired to continue the service "So long as it remains in business in the State". The N F & G Co does much business in the State; & To avoid its obligation to serve in those Cities caused the Marfield Co to be created & handed over to it property-hereof to those places, now it has no State lines &c - But N F. G owns all shares &c the Marfield Co is a Creature & instrumentality. Hickenlooper D.J. held both bound to serve & subject to the regulations imposed by rule.

Appellant Contends -

1. by Const prov No Co shall use Charter of Corporation without it Consent through its Legislature body. Franchises to 20 yrs must go to highest bidder - They say that ordinance forbidding withdrawal is violation of that - [But

① the Marfield Co may be identified as the same Company as N.F.G -

(2)

Immediately after Creation Co. pet for Comm'n for reasonable rates. This is a qu. of State law. There seem to be no binding authorities.

2. Tests of Act not broad enough to cover the powers exercised by the Comm'n to require Service & Rates other than those have expired.

[This is a State qu. The title seems rather narrow. But State dec' seems liberal on this point. Probably wise not to assume that other Contention in absence of binding decision of State Sup Ct]

See Ch 21, 1913 Vol. 526

4 (1)

This is an appeal from dec' denying a temp injunction. The testimony taken before the Com'r & additional testimony given orally in Open ct were submitted on in support of the application. There seems to have extended & full hearing on applicat for temp' injunction. The decree appealed from is interlocutory - It is open to the parties to apply at the trial to supply omissions if any, & generally to substitute new evidence as it has to support or negative conflicting - It is doubtful whether the presentation of the case was as full as would be desirable at trial upon the merits - The question here is whether, pending final determination, the status quo should be changed by the application of higher rate - While the Company may not ultimately

be made ~~so~~ whole if the rates are adjudged to be too low? Provision may be made for the protection of the consumer if a ~~Schedule~~ per cent rate ~~like~~ shall be found too high, the burden is nevertheless ~~on~~ the Company to ~~make~~ ~~a presumption pending which~~ ~~it is for consideration will~~ exert some persuasive force that it has a good case. ~~The matter is not clear~~

Is it clear that the denial of the Company application was an improvident exercise of judicial discretion?

~~Mar Rep. Ch 75 - 11 Va 91~~

1270 D 184 Com'l added $1000000 Rev

exercise of judicial discretion.?

The question concerns the proportion not applicable to a return on the property used to render the service covered by the rates.

It is settled that where a company has two classes of business, one certain the rate-making jurisdiction of the State and the other beyond such jurisdiction, the company is not so entitled to make the

Consumers in the regulated class pay higher rates in order to make up losses, or inadequate returns, in the unregulated businesses.

A schedule, in order to be valid, need not be adjusted to yield like percentage, of ~~so~~ or reasonable profit, on every item. It is valid if the regulated business as a whole yields a fair return on the ~~entire~~ property value mostly attributable to the service covered by the Schedule - But a rate that results in an actual out of pocket loss cannot be sustained.

2/ Gasoline is demanded from the Crude used in regulated Service.

(6) Court found favorable ~~was~~ purchases from investments - a use rather than sale of productions.

c Took on half profits or what to Court Ruan sold the privilege or forbore 1/2 the net

[Why invite the by product like the Mfre of Coke & Gas in making Artificial Gas. On the other hand it may be said that the Utility had a right to determine for itself whether it should engage in the gasoline business. It is said by the Court that making gasoline is a separate business (1 P.S.C. W. Va 539 - 3-20)]

-d- Sales to parent Cos apparently not taken into consideration by the Court below.

But sup Ch 95 - 11 Va 91

1270 Ship Coms added £1000000 Rev from repeated business

187 / 5000 — £11800000. Op x includes 3 65- for depreciation = 8% return

Make 11.65 for divisor =

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1927.

UNITED FUEL GAS COMPANY and WARFIELD NATURAL GAS COMPANY, Appellants, vs. THE RAILROAD COMMISSION OF KENTUCKY, FRANK N. BURNS, OSCAR VEST and ISAAC WILDER, members of and constituting said The Railroad Commission of Kentucky, and FRANK E. DAUGHERTY, Attorney General of the State of Kentucky, Appellees.	No. 19.

BRIEF ON BEHALF OF APPELLANTS.

Prefatory Note.

This is an appeal from a judgment* of the District Court of the United States for the Eastern District of Kentucky, entered on the 12th day of May, 1925 (R., p. 1595), denying the appellants the relief prayed for in their bill, which sought to enjoin the Railroad Commission of Kentucky and the members thereof from interfering or preventing the appellants from discontinuing gas service in the cities of Ashland, Catlettsburg and Louisa, Kentucky, or, in the alternative, enjoining, inhibiting and restraining said Commission and its members from preventing the appellant Warfield Natural Gas Company from establishing the schedule of rates filed by it; and for other appropriate relief as prayed for in its bill (R., pp. 1-22).

*So termed by the Court (R., 1595).

Opinion Below.

The opinion of the court below is reported in 13 Fed. (2d), 510, and also appears at pages 1566 *et seq.* of the record.

Jurisdiction of the Court.

The court has jurisdiction of this appeal under Judicial Code, Sec. 238 (U. S. Code, Title 28, Sec. 345). The judgment appealed from was entered on May 12, 1925, prior to the effective date of the amendment of February 13, 1925.

Ex parte Buder, 271 U. S. 461;
Moore vs. *Fidelity & Deposit Co.*, 272 U. S. 317.

The specific claims advanced and rulings made in the lower court which are relied on as the basis of this court's jurisdiction, with a specification of such of the assigned errors as are intended to be urged, precede the argument (p. 9, *infra*).

Statement of Facts.

The appellant United Fuel Gas Company is now, and has been for a number of years, engaged in production of natural gas in the State of West Virginia and in supplying it to various consumers in said State of West Virginia, as well as to certain other companies who transport it and sell it in other states. In the year 1909, it acquired the plants of the United States Natural Gas Company in the cities of Ashland, Catlettsburg and Louisa, Kentucky, which were then being operated under franchises for that purpose. These franchises were granted for a definite number of years, that in the City of Catlettsburg expiring on the 21st day of January, 1918, that in the City of Ashland on the 3rd day of January, 1918, and that in the City of Louisa on the 1st day of July, 1918. (See paragraph IV of bill, record p. 4, and paragraph IV of answer, record p. 743.)

Notwithstanding the expiration of said franchises, the United Fuel Gas Company continued to supply gas to said three cities until it sold and conveyed its property in the State of Kentucky to the appellant Warfield Natural Gas Company in June, 1923 (R., 425-40), since which time the service has been performed by the Warfield Company. This conveyance was made on June 28th, 1923, and after its execution and delivery the United Fuel Gas Company withdrew from and ceased to engage in business in the State of Kentucky, and cancelled, in due form, the appointments previously made by it of any and all agents upon whom process against it might be served and gave notice thereof to the Secretary of State of the State of Kentucky as required by law (R., p. 8).

In the year 1920, the General Assembly of the Commonwealth of Kentucky passed an Act, known as Chapter 61 of the Acts of the General Assembly of 1920 (R., pp. 22 *et seq.*; Acts 1920 of Kentucky, p. 250). Among other things, Section 23 of said Act provides:

> "If the franchise of any public service company embraced in this act shall have expired, and the service is continued without obtaining a new franchise, the said public service company shall be subject to the jurisdiction and authority of the Railroad Commission, and shall not withdraw its service from any municipality, county or community without first obtaining the permission of the said Railroad Commission so long as it remains in business in this commonwealth, or any part thereof."

Other provisions of the statute purport to grant to the Railroad Commission power and authority to investigate, upon complaint, whether any company engaged in the distribution, furnishing or sale of natural gas is collecting or receiving extortionate rates, and upon a finding that extortionate rates are being collected and charged, to fix a just and reasonable rate for the furnishing and sale of natural

gas, and providing penalties in case anyone engaged in said business continues to charge rates so found to be exorbitant.

On or about the 28th day of April, 1920, the City of Catlettsburg, acting under the authority of this statute, filed a complaint with the Railroad Commission against the appellant United Fuel Gas Company (R., p. 163), in which it was alleged that the rates then being charged for natural gas by that Company in the City of Catlettsburg were unreasonable, unjust and extortionate, and praying that the Commission establish a reduced rate to be thereafter charged. The cities of Louisa and Ashland filed intervening petitions in this proceeding (R., pp. 77-86).

At the time of the filing of this complaint the rate being charged by the United Fuel Gas Company was 40 cents per thousand cubic feet, with a discount of 5 cents per thousand for payment on or before the tenth day of the month for the gas consumed during the preceding month. This rate applied to what is termed "domestic service", a somewhat less rate being charged to industrial consumers, due to the fact that such consumers use large quantities of gas and use the same with more uniformity throughout the seasons.

The United Fuel Gas Company filed a motion to dismiss said complaints and each of them (R., pp. 43-162), on the ground that the Commission was without jurisdiction to hear and determine the matters arising thereon, and also answered denying the material allegations of said petitions and expressly denying that the rates charged were unjust, unreasonable, extortionate or discriminatory (R., pp. 43-162).

A hearing was had before the Commission, and thereafter, on the 18th day of January, 1922, the Commission entered an order to the effect that any rate in excess of 80% of the existing rate was unreasonable and extortionate, and directed the Company to put in effect a rate in accordance with said order (R., p. 7).

On the 24th day of January, 1922, the United Fuel Gas Company moved the Commission to rehear the cause and to revoke and set aside said order, on the ground that the rates prescribed by the order did not afford to the petitioner reasonable compensation for the service and would deprive it of its property without just compensation therefor. It further asked the Commission to construe said order and definitely declare whether the petitioner would be entitled to charge 80% of the 40 cents which it then charged, or 80% of 35 cents, being the rate then existing after deducting 5 cents for prompt payment (R., pp. 105 *et seq.*). The Commission, however, refused to grant this petition for rehearing and refused to construe its order (R., p. 101). In the petition for rehearing the petitioner advised the Commission that it would construe the order as fixing the rate at 32 cents unless the Commission directed otherwise. The Commission not explaining or construing its order, the plaintiff United Fuel Gas Company put in effect a rate of 32 cents, with a discount of 1 cent per thousand cubic feet for prompt payment, and continued to charge this rate, without objection, until it conveyed its property to the plaintiff Warfield Natural Gas Company in June, 1923, and ceased to do business in the State of Kentucky.

At the time the Warfield Natural Gas Company took over said properties, to-wit, on the 28th day of June, 1923, it caused to be printed, published and posted a schedule of rates which it would charge for natural gas at all points in the State of Kentucky. This schedule provided a rate for the cities of Ashland, Catlettsburg and Louisa, for domestic service, of 45 cents per thousand cubic feet, with a discount of 5 cents per thousand cubic feet for payment on or before the tenth day of the month for the gas consumed in the preceding month, effective on the 1st day of August, 1923, and was filed with the defendant Railroad Commission as required by law (R., p. 34). Upon the filing of this schedule the said cities of Ashland, Catlettsburg, and Louisa filed a

protest against the same going into effect (R., pp. 399 *et seq.*). On the 11th day of July, 1923, the United Fuel Gas Company filed a motion in writing before the Railroad Commission of Kentucky, showing that it had transferred its property in the State of Kentucky to the Warfield Natural Gas Company, and that that Company had filed a schedule of rates which would go into effect on the 1st day of August, 1923, and asking that its former order entered on the 18th day of January, 1922, be set aside and cancelled (R., p. 379). Said Commission did not at that time take any action upon this motion.

The Warfield Natural Gas Company, on the 29th day of August, 1923, filed with the Railroad Commission a petition showing that it had acquired the properties of the United Fuel Gas Company in the State of Kentucky, that it had made a contract with the United Fuel Gas Company for the purchase of gas from it to supply the cities of Ashland, Catlettsburg and Louisa, and that it had filed a schedule of rates to be effective on August 1st, as aforesaid, averring said rates so proposed to be charged to be just and moderate and that any less rates would be unreasonable and confiscatory, and in particular alleging that the rates prescribed in the order of the Commission of January 18, 1922, if operative upon petitioner, would be unjust, unreasonable and confiscatory, and averring other facts tending to show the reasonableness of the rates proposed by it. It asked the Commission to approve said schedule and put said rates in effect, and in case this was not done, that said petition might be regarded as the application of the Warfield Natural Gas Company to withdraw its service from each of said municipalities (R., pp. 369 *et seq.*). The cities of Ashland, Catlettsburg and Louisa responded to this petition, and in their answers contended that the order of the Commission of the 18th day of January, 1922, above referred to, was binding upon the Warfield Natural Gas Company; that the true meaning of said order was that it fixed the rate to be

charged at 80% of 35 cents, the net rate, instead of 80% of 40 cents, the gross rate theretofore charged, and demanded reparation on behalf of the consumers (R., pp. 399 *et seq.*).

The Commission held a hearing upon this petition, as well as upon the motion of United Fuel Gas Company aforesaid, and on the 11th day of December, 1923, entered an order dismissing the petition of the Warfield Natural Gas Company and the said motion of the United Fuel Gas Company, and denying the rate proposed to be put in effect on the 1st day of August, as aforesaid, holding that the order of January 18, 1922, prescribed a rate of 80% of 35 cents instead of 80% of 40 cents, and that the proper rate to be charged was 28 cents, and requiring the petitioners to continue furnishing gas service to said cities at the rate of 28 cents and inviting all consumers who had paid in excess of that rate since the 18th day of January, 1922, to file claims for reparation, which would be awarded (R., pp. 39-388).

The appellants thereupon brought this suit for the purpose of having declared void the orders of the Railroad Commission, above referred to, and of enjoining the Commission from enforcing said orders against the said plaintiffs or either of them, and of enjoining the Railroad Commission from interfering with the Warfield Natural Gas Company in putting in effect its new schedule of rates, or from preventing it from withdrawing from the cities involved (R., pp. 1-22). A temporary restraining order was granted enjoining the defendant Railroad Commission from putting in effect said orders (R., p. 1592). A motion for a temporary injunction was made before Circuit Judge Denison and District Judges Jones and Hickenlooper, and on October 21, 1924, an order was entered continuing in effect the arrangement made under the temporary restraining order until the final hearing (R., p. 1593). Upon the final hearing of the cause before District Judge Hickenlooper, it was held that the rate as fixed by the orders of the Railroad Commission of Kentucky was 32 cents and not 28 cents, and the said

Railroad Commission was enjoined from attempting to enforce any lower rate. The further relief asked for, to-wit, that the said Railroad Commission be enjoined from enforcing its order requiring the plaintiffs to continue their service, or that the rate schedule as filed, effective on the 1st day of August, 1923, be allowed, was denied (R., p. 1595).

The contention of the appellants is that the Railroad Commission of Kentucky had no authority to compel them to continue gas service to the cities of Ashland, Catlettsburg and Louisa, for two reasons: First, because the Act of the General Assembly of Kentucky, under which said Commission was acting, is invalid as violative of Section 51 of the Kentucky Constitution, in that the title of the Act does not cover the part thereof attempted to be enforced against the plaintiffs; and second, because the franchises under which gas was being furnished to these cities had expired and no contract could be made under the provisions of Sections 163 and 164 of the Kentucky Constitution for furnishing such gas service, except in accordance with the provisions of those sections; and further, even though it be held that the Warfield Natural Gas Company is under obligation to furnish such service, the rate prescribed by the Railroad Commission's order and approved by the court below, does not give to the Warfield Natural Gas Company just compensation for its property, and is violative of the provisions of the Federal Constitution forbidding the taking of private property for public use without just compensation.

To support its contention that the rate fixed by the order of the Railroad Commission of Kentucky, even as interpreted by the court below, deprived it of its property without due process of law, the appellant Warfield Natural Gas Company introduced upon the hearing evidence of the value of its property, as well as evidence of the value of the property of United Fuel Gas Company. The appellant United Fuel Gas Company, as hereinbefore stated, was formerly the owner of the property now owned by the Warfield

Natural Gas Company, and the supply of gas which the Warfield Company delivered to its consumers was furnished to it by the United Fuel Company at a rate of 30 cents per thousand cubic feet, delivered at the Big Sandy River, the line between Kentucky and West Virginia. It was recognized however, that inasmuch as all of the stock of the Warfield Company was held by the United Fuel Company, the court would not perhaps give full effect to the provisions of that contract, and the appellant felt under the necessity of showing that the rate of 30 cents per thousand cubic feet provided in that contract was justified. Detailed inventories were made of all the property of both Companies, and evidence of the value of these properties was submitted upon the hearing. We will not undertake at this point to repeat this evidence or do more than to say that there is no controversy between any witnesses as to matters of fact upon questions of value, but only upon matters of theory in regard thereto. Hereafter, in the discussions of these theories presented by the several witnesses and experts, we will refer at large to their evidence.

Specification of Errors Relied Upon.

First. The court below erred in refusing to enjoin the Railroad Commission of Kentucky from executing its order requiring the appellants to continue gas service to the cities of Ashland, Catlettsburg and Louisa, for the reasons:

(a) The said Railroad Commission's order requiring the plaintiffs to continue such gas service after the expiration of the franchises is invalid under the Constitution of Kentucky as construed by the Court of Appeals of that State, and the court should have enjoined the Railroad Commission from enforcing said order and requiring appellants to continue said service.

(b) The Kentucky statute, Chapter 61 of 1920, is void insofar as it affects the plaintiffs, because that part of the

subject-matter of such statute which the Railroad Commission undertook to enforce against the plaintiffs is not embraced in the title thereof as required by Section 51 of the Constitution of Kentucky.

Second. The court erred in not holding that the order of the Railroad Commission of Kentucky requiring the plaintiffs to continue said service and holding that the rates fixed in its schedule were exorbitant, was void for lack of any finding by said Railroad Commission of the essential facts upon which to base said order; and further, that there was no evidence before said Railroad Commission from which such a finding of essential facts could be made.

Third. The court below erred in ascertaining and fixing the value of the gas rights or leaseholds of the appellants at not more than $6,732,920.00 for rate-making purposes, for the reason that said finding is in conflict with the uncontradicted evidence that the value of these gas rights or leaseholds is at least $30,000,000.00.

Fourth. The court erred when arriving at the value of plaintiff's plant in not making proper allowances for interest during construction, cost of financing and overhead charges.

Fifth. The court erred in refusing to allow any more than $3,000,000.00 for going concern value.

Sixth. The court erred in holding that depletion and amortization could be amply provided for by an allowance of 4½% of the depreciable and depletable rate base, and 1½% to meet charges for depreciation, repair and replacement.

Seventh. The court erred in including in the earnings of the appellants one-half of the net earnings from the extraction of gasoline by the Virginian Gasoline & Oil Company.

Eighth. The court erred in holding that the rates fixed by the Railroad Commission of Kentucky were not confiscatory.

ARGUMENT.

First.

(a) The Railroad Commission's order requiring the plaintiffs to continue gas service to the cities of Ashland, Catlettsburg and Louisa after the expiration of the franchises, is invalid under the Kentucky Constitution as construed by the Court of Appeals of Kentucky, and the court should have enjoined the Railroad Commission from enforcing said order and requiring appellants to continue said service.

Sections 163 and 164 of the Constitution of Kentucky provide:

> "No street railway, gas, water, steam heating, telephone, or electric light company, within a city or town, shall be permitted or authorized to construct its tracks, lay its pipes or mains, or erect its poles, posts or other apparatus along, over, under or across the streets, alleys or public grounds of a city or town, without the consent of the proper legislative bodies or boards of such city or town being first obtained; but when charters have been heretofore granted conferring such rights, and work has in good faith been begun thereunder, the provisions of this section shall not apply."

> "No county, city, town, taxing district or other municipality shall be authorized or permitted to grant any franchise or privilege, or make any contract in reference thereto, for a term exceeding twenty years. Before granting such franchise or privilege for a term of years, such municipality shall first, after due advertisement, receive bids therefor publicly, and award the same to the highest and best bidder; but it shall have the right to reject any or all bids. This section shall not apply to a trunk railway."

The franchises of the appellants having expired, they could be renewed, if at all, only in conformity to these constitutional provisions. The Act of 1920, Sec. 23 (*supra*, p. 3) was clearly an attempt on the part of the General Assembly to substitute for these provisions the mandate of the Railroad Commission forbidding withdrawal, thus in effect creating a new franchise or continuing the original franchise beyond its stipulated term. It is submitted that the question is put at rest by numerous decisions.

These sections of the Constitution of Kentucky have been construed by the Court of Appeals of that State in the cases of *Rural Home Telephone Co.* v. *Kentucky & Indiana Telephone Co.*, 128 Ky. 209, 107 S. W. 787, *City of Princeton* v. *Princeton Electric Light & Power Co.*, 166 Ky. 730, 179 S. W. 1074, and *Union Light, Heat & Power Co.* v. *City of Fort Thomas*, 215 Ky. 384, 285 S. W. 228; and by the District Court for the Eastern District of Kentucky in *Union Light, Heat & Power Company* vs. *R. R. Com. of Kentucky*, 17 Fed. (2d) 143.

In the case of *Rural Home Telephone Co.* v. *Kentucky & Indiana Telephone Co., supra*, it appeared that the Kentucky & Indiana Telephone Co. owned and operated a telephone exchange in the City of Owensboro. The Rural Home Telephone Co. owned and operated a telephone system outside of said City of Owensboro. These systems were connected with each other and the subscribers of each were enabled to communicate with the subscribers of the other. A change of ownership was had of the Rural Home Telephone Co. property and its connection with the Kentucky & Indiana Co. severed. Section 199 of the Kentucky Constitution required telephone companies operating exchanges in different towns or cities or other public stations to receive and transmit the messages of other such companies without unreasonable delay or discrimination. Upon the refusal of the Rural Home Co. to establish a connection with it, the Kentucky & Indiana brought suit to compel such connection, and the court

below granted the relief asked, enjoining the other company from cutting or severing the connection or interfering in any way with the plaintiff's exchange, and enjoining it from refusing to receive and transmit messages coming from or through or destined to or from plaintiff's exchange. Upon the appeal it was insisted that the Kentucky & Indiana Co. could not maintain the suit for the reason that it had no lawful franchise to operate a telephone system over the streets of the City of Owensboro, it not having been granted such a franchise in accordance with the provisions of Sections 163 and 164 of the Constitution. The court, in construing these provisions, held that they provided an exclusive method by which a city could contract or grant such a franchise, and that no rights could be acquired from the city by any other method nor could the city grant any such rights in any other way, and that the complaining telephone company was a trespasser upon the streets of the city and could not require a connecting telephone company to receive and transmit its messages. Applying this construction to the status of the plaintiffs here, it must be conceded that neither of them has any rights under the expired franchises in Ashland, Catlettsburg and Louisa, and if the construction adopted in that case be correct that their continuance to carry on the business therein makes them trespassers and violators of the constitutional provisions, then the order of the Railroad Commission requiring them to continue this service after the expiration of said franchises, as well as the order of the court below, compels them to continue to violate the law in opposition to their desire to desist therefrom.

In the case of the *City of Princeton* v. *Princeton Electric Light & Power Co., supra*, the Electric Light Co. had a proper franchise for a period of ten years. The council of the Town of Princeton attempted to extend the franchise, by an agreement with the Company, for an additional ten years without advertising or complying with the provisions of Sections 163 and 164 of the Constitution, and the service was continued

for a considerable part of this time. The court, in passing on this situation, held that the Electric Light Co. was a bare licensee after the expiration of the franchise. It held, as in the former case, that no rights of this character could be acquired from the city, nor could the city grant any rights of such character, except in the manner prescribed by the constitutional provisions above quoted. That the Electric Light Co. could not collect from the city for electricity furnished it in accordance with a contract not made in compliance with the fundamental law, and that it would be compelled to discontinue its business, but that in view of the fact that it was a licensee, it would be permitted to dismantle and remove its plant.

In the case of *Union Light, Heat & Power Co.* v. *City of Fort Thomas, supra*, the franchise of the Gas Company was about to expire and it had given notice that it would discontinue service at the expiration of the franchise. The city secured an injunction preventing it from discontinuing the service, and it was compelled to furnish the service after the expiration of the franchise under the injunction. The Circuit Court perpetuated the injunction, but on appeal to the Court of Appeals of Kentucky the injunction was dissolved and the bill dismissed, the court again holding that Sections 163 and 164 provided an exclusive method by which such franchise could be granted, and that no rights could be acquired in any other way nor could any be granted by the city in any other way. It is true in that case that Section 23 of the Act of 1920 was referred to and was construed as not applying, for the reason that the service rendered after the expiration of the franchise was involuntary; but the effect of the court's decision in all three of these cases is that if Section 23 of the Act of 1920 be construed as requiring a company that continues a service after the expiration of its franchise to go on indefinitely with that service, at rates prescribed by the Railroad Commission, then it violates Sections 163 and 164 of the Constitution. If the Act is valid at all the

only effect that this section of the Act can have is to give the Railroad Commission power to prescribe rates for service of this character, when voluntarily rendered without a contract or franchise therefor. It would seem clear that the Railroad Commission's order requiring the Warfield Natural Gas Company not only to continue to furnish the service to the inhabitants of the cities of Ashland, Catlettsburg and Louisa, but to extend its mains and pipes upon the demand of said inhabitants (R., 388), is invalid, and the Railroad Commission should have been enjoined from enforcing this order against the plaintiffs or either of them.

In the case of *Union Light, Heat & Power Company* v. *Railroad Commission of Kentucky*, 17 Fed. (2d), 143, the District Court for the Eastern District of Kentucky, composed of Circuit Judge Moorman and District Judges Hicks and Dawson, considered the question here involved. In that case the Railroad Commission made an order requiring the Union Light, Heat & Power Company to continue gas service to the city of Fort Thomas, notwithstanding the expiration of the Company's franchise. The Gas Company applied to the District Court for an injunction to inhibit the Railroad Commission from enforcing said order, and this injunction was granted upon the ground herein urged as that upon which the injunction should have been granted in this case. In the opinion in that case, at page 148, the court said:

> "In an unbroken line of cases, the Kentucky Court of Appeals has held that these two sections of the Constitution are mandatory and must be read together, and that no franchise to occupy the streets and public ways of a municipality of the commonwealth can be acquired in any other way than by a strict compliance with these two sections. There must be a public advertisement for bids; the bids must be received publicly; the franchise must be awarded to the highest and best bidder, and cannot be granted for a period in excess of twenty years, and upon the expiration of the life of the franchise the owner thereof has no right to longer occupy and use the

public ways of the municipality, and can acquire no such right, nor can the city grant any such right, except that a new sale is effected under the provisions of sections 163 and 164 of the Constitution. These decisions of the Court of Appeals of Kentucky, construing its own Constitution and involving no federal question, are binding upon us.

"The franchise involved in this case, by its express terms, ran for a period of ten years from and including September 6, 1915. Therefore, under sections 163 and 164 of the Constitution of Kentucky, as construed by the Court of Appeals of the state, the plaintiff had no right under that franchise to occupy the streets and public ways of the city of Ft. Thomas after the 5th day of September, 1925, and the city was without power to confer upon it any such right, except in the same way as the original franchise was granted. Cases illustrating the strictness with which these two sections of the Kentucky Constitution have been applied are: Rural Home Telephone Co. v. Kentucky & Indiana Telephone Co., 128 Ky. 209, 107 S. W. 787; Princeton v. Princeton Electric Light & Power Co., 166 Ky. 730, 179 S. W. 1074; City of Somerset v. Smith, 105 Ky. 678, 49 S. W. 456; People's Electric Light & Power Co. v. Capital Gas & Electric Light Co., 116 Ky. 77, 75 S. W. 280; Hamilton v. Bastin Bros., 188 Ky. 764, 224 S. W. 430; East Tennessee Telephone Co. v. Anderson County, 115 Ky. 588, 74 S. W. 218.

"Therefore, looking alone to the two state constitutional provisions under consideration, it seems perfectly obvious that all obligation on the part of the plaintiff to furnish gas service to the citizens of Ft. Thomas terminated upon the expiration of its franchise, and that any attempt on the part of the Kentucky Railroad Commission to force a continuation of the service after the expiration of the franchise would be writing into the contract of the plaintiff an obligation which it did not assume, and therefore would be violative of section 10 of article 1 of the Constitution of the United States."

(b) The Kentucky statute, Chapter 61 of 1920, is void so far as it affects the plaintiffs, because that part of the subject-matter of such statute which the Railroad Commission undertook to enforce against the plaintiffs is not embraced in the title of said statute as required by Section 51 of the Kentucky Constitution.

Section 51 of the Kentucky Constitution is as follows:

> "No law enacted by the general assembly shall relate to more than one subject, and that shall be expressed in the title, and no law shall be revised, amended, or the provisions thereof extended or conferred by reference to its title only, but so much thereof as is revised, amended, extended or conferred, shall be re-enacted and published at length."

Under this section the Kentucky Court of Appeals has held, in a long line of decisions, that the title to an act must clearly indicate the subject-matter of the legislation, and any subject-matter embraced in the act, but not embraced in the title, was not valid.

Burton v. *M. & B. Turnpike Co.*, 162 Ky. 787; 173 S. W. 144;

Henderson Bridge Co. v. *Alves*, 122 Ky. 46; 90 S. W. 995;

Thompson v. *Commonwealth*, 159 Ky. 8; 166 S. W. 623;

Houston v. *Boltz, Judge*, 169 Ky. 640; 185 S. W. 76;

Bosworth v. *State University*, 166 Ky. 436; 179 S. W. 403;

Ogden v. *Cronan*, 171 Ky. 254; 188 S. W. 357;

Exall v. *Holland*, 166 Ky. 315; 179 S. W. 241;

Fitzpatrick v. *McGinnis*, 174 Ky. 600; 192 S. W. 651;

South v. *Fish*, 181 Ky. 349; 205 S. W. 329;

Commonwealth v. *Moore*, 187 Ky. 494; 219 S. W. 786.

In *South* v. *Fish, supra*, it was said (205 S. W. at p. 332):

> "It has been aptly said that the purpose of this constitutional provision concerning title to legislative acts is, first, to prevent log-rolling legislation; second, to prevent surprise or fraud upon the legislature by means of provisions in bills of which the titles give no intimation, and which might, therefore, be overlooked, and carelessly and unintentionally adopted; and, third, to fairly apprise the people, through such publication of legislative proceedings as is usually made, of the subjects of legislation that are being considered, in order that they may have opportunity of being heard thereon."

The Act of March 22, 1920 (Chapter 61), is entitled "An Act to repeal and re-enact Chapter 18 of the Acts of 1916 • • • so as to prescribe the duties and powers of the Railroad Commission with reference to" certain companies, including natural gas companies and natural gas transportation companies. It will be observed that the Act of 1920 and also the Act of 1916 were expressly entitled "Acts to prescribe the duties and powers of the Railroad Commission." There was nothing in the title of either act to indicate the regulation of public utilities, or the defining of the duties of such companies, or the imposing of obligations upon them. Yet nearly all of the act relates to such subjects, and but little of it refers to the duties of the Railroad Commission. The original Railroad Commission act (approved March 2, 1900, c. 2) had a proper title, which is recited in

> *McChord* v. *L. & N. R. R. Co.*, 183 U. S. 483, 46 L. Ed. 289;
> *Siler* v. *L. & N. R. R. Co.*, 213 U. S. 175, 53 L. Ed. 753.

But when the General Assembly came to pass the Act of 1916, and, again in the Act of 1920, it omitted the essentials of the title necessary to render it valid under Section 51 of the State Constitution. The title of the original Act was: "An Act to prevent railroad companies or corporations owning and operating a line or lines of railroad, and its officers,

agents, and employees from charging, collecting or receiving extortionate freight or passenger rates in this Commonwealth, and to further increase and define the duties and powers of the railroad commission in reference thereto, and prescribing the manner of enforcing the provisions of this act and penalties for the violation of its provisions." The departure from this form of title was so radical and so obvious as to render the Act of 1920 unconstitutional under Section 51 of the Kentucky Constitution and the settled construction thereof.

It will be observed that the Act in question, while purporting in the title only to prescribe certain duties of the Railroad Commission as applied to certain companies, yet imposes obligations and burdens upon other people and corporations, fixes penalties, prescribes remedies and limitations, and deals with a number of subjects not referred to at all in the title or embraced in anything mentioned therein. For instance, the Act relates to such subjects as tolls, fares and rates (Secs. 2, 3, 4, 5, 6, 7, 8 and 14), reparations (Sec. 17), courts and jurisdiction (Secs. 12 and 21), definition of crimes (Secs. 10, 11 and 13), creation of offenses and prescribing of penalties (Secs. 9, 12, 14 and 15), limitations of prosecutions (Secs. 12, 14 and 22), manner and means of enforcing the Act (Secs. 14 and 21), duties of sheriffs (Sec. 19), duties of the Attorney General (Sec. 21), and affecting public service corporations whose franchises have expired, and the right of withdrawal from business in the state (Sec. 23). None of these subjects are even indicated in, much less embraced by, the title of the Act. They are not included in any duties or powers of the Railroad Commission. The Act is apparently pieced together from the various acts relating to railroad companies (Secs. 816 to 829) and the title was not prepared to express any particular purpose or to comprehend any considered plan of legislation.

(See Kentucky Railroad Statutes, copied in full with Supreme Court opinion in *McChord* v. *L. & N. R. R. Co.*, 183 U. S. 483, 46 L. Ed. 289-293.)

Under the settled construction of Section 51 of the Constitution, such slip-shod legislation is void.

The court below cited (R., 1572; 13 Fed. (2nd) at p. 516) the case of *Eastern Ky. Coal Land Corp.* v. *Commonwealth*, 127 Ky. 667, 106 S. W. 260, as authority for sustaining the validity of this act. The title of the act involved in that case was "An Act relating to Revenue and Taxation". In the body of the act there was a provision forfeiting land title for failure to pay taxes. The reading of the opinion in that case will disclose that the act was sustained solely upon the ground that the title was an historic one, the court saying (106 S. W. at p. 271):

> "the subject has from the beginning in this state, and prior and since in Virginia, been treated as embracing the identical features now brought forward, so that if any one concerned in such legislation, whether a member of the assembly or a landowner looking out for his interests, would naturally have expected to find such legislation under that title, and reasonably all that was germane to the subject treated under the one head."

But this reasoning could not apply in this case, as this is the first act on the subject, so that it has no historic title. In fact, the title to the original Railroad Commission act was adequate, but it was not followed in either of the amendments of 1916 or 1920.

Second.

The orders attacked in this proceeding are void for the reason that there was no evidence upon which they could be based or justified, nor was there any finding of essential facts upon which to predicate them.

It will be borne in mind that the Kentucky statute referred to does not provide for any judicial review of the acts of the

Railroad Commission. In such a case, it is insisted that before a rate can be held to be extortionate there must be evidence offered and a finding made based upon that evidence which justifies the conclusion. In the case of *Wichita Railroad & Light Co.* v. *Public Utilities Commission of Kansas*, 260 U. S. 48, 67 L. Ed. 52, it is said (260 U. S. at p. 58):

> "The proceeding we are considering is governed by Sec. 13. That is the general section of the act comprehensively describing the duty of the commission, vesting it with power to fix and order substituted new rates for existing rates. The power is expressly made to depend on the condition that, after full hearing and investigation, the commission shall find existing rates to be unjust, unreasonable, unjustly discriminatory, or unduly preferential.
>
> "We conclude that a valid order of the commission under the act must contain a finding of fact after hearing and investigation, upon which the order is founded, and that, for lack of such a finding, the order in this case was void.
>
> "This conclusion accords with the construction put upon similar statutes in other states. State Public Utilities Com. v. Springfield Gas & Elec. Co., 291 Ill. 209; [125 N. E. 891]; State Com. v. B. & O. So. West. R. Co., 281 Ill. 405; [118 N. E. 81].
>
> "Moreover, it accords with general principles of constitutional government. The maxim that a legislature may not delegate legislative power has some qualifications as in the creation of municipalities, and also in the creation of administrative boards to apply to the myriad details of rate schedules the regulatory police power of the state. The latter qualification is made necessary in order that the legislative power may be effectively exercised. In creating such an administrative agency, the legislature, to prevent its being a pure delegation of legislative power, must enjoin upon it a certain course of procedure and certain rules of decision in the performance of its functions. It is a wholesome and necessary principle that such an agency must pursue the procedure and rules enjoined, and show a substantial compliance therewith, to give validity to its action. When, there-

> fore, such administrative agency is required, as a condition precedent to an order, to make a finding of facts, the validity of the order must rest upon the needed finding. If it is lacking, the order is ineffective."

In the case of *Illinois Central R. R. Co.* v. *Kentucky R. R. Com.*, 1 Fed. (2d) 805, decided by a special statutory three-judge court composed of Judges Denison, Cochran and Sater, it was said (p. 808):

> "Since the statute does not provide for any judicial review, an order made by the Commission without any substantial evidence upon which to base it is arbitrary, is not due process of law and calls upon any court of competent jurisdiction to enjoin its execution. In a proper case the court will proceed upon this ground; and since all the evidence that was before the commission is exhibited to us, the question is here open. These propositions, too, are well settled."

The statute referred to in this last case is the Kentucky statute involved here.

In *Interstate Commerce Commission* v. *Louisville & Nashville R. Co.*, 227 U. S. 88, 57 L. Ed. 431, it was held

> "A finding without evidence is arbitrary and baseless."

The entire records on both hearings before the Railroad Commission in this case will be found exhibited with the bill as Exhibits "B" and "E", Exhibit "B" embracing the first hearing (R., 41-366) and Exhibit "E" the second hearing (R., pp. 367-738). This evidence upon these hearings was exhibited with the bill at length in order that the court might see that there was no evidence offered justifying the conclusion that the rates were exorbitant, nor was there any finding of facts made by the Commission from which this conclusion could be deduced. The Commission spoke only by its naked orders (R., 103, 387). The only witness offered on behalf of the protestant cities was W. H. Weiss (R., p. 109), and he testified to the original cost of appellants' property only as re-

flected by the books, although it appears that such property has largely enhanced in value since it was acquired. Particularly is this true of that part of it which consisted at the time of its acquisition of undeveloped gas territory, which, at the time of the hearing, had been developed and proven to be highly productive of natural gas. No attempt was made to show the present value of the property except by the appellants here, and the showing made by the appellants, as will appear from the evidence of S. S. Wyer (R., p. 167), I. C. White (R., p. 51) and H. A. Wallace (R., p. 245), is very far from justifying the conclusion that the rates are exorbitant. This testimony shows that the value of the property at the time of the hearing was largely in excess of its original cost, and that the original cost was no measure whatever of its value. It is therefore respectfully submitted, under the above authorities, that the orders of the Railroad Commission are not founded upon the evidence, are without any basis or justification and should have been held to be invalid for this reason.

Third.

The court erred in ascertaining and fixing the value of the gas rights or leaseholds of the appellants at not more than $6,732,920.00 for rate-making purposes, for the reason that said finding is in conflict with the uncontradicted evidence that the value of these gas rights or leaseholds is at least $30,000,000.00.

It is well settled by the decisions of this Court that in arriving at a rate base the matter to be determined is the present fair value of the property which enters into it and not the original cost of that property, whether the latter be greater or less than the former.

Willcox vs. *Consolidated Gas Company*, 212 U. S. 19, 52;

Minnesota Rate Cases, 230 U. S. 352, 454;

Bluefield Water Works & Improvement Company vs. *Public Service Commission*, 262 U. S. 679, 690;

Ohio Utilities Company vs. *Public Utilities Commission of Ohio*, 267 U. S. 359, 363;

Board of Commissioners vs. *New York Telephone Company*, 271 U. S. 23, 31;

McCardle vs. *Indianapolis Water Company*, 272 U. S. 400, 410.

At the time the United Fuel Gas Company conveyed the Kentucky properties to the Warfield Natural Gas Company, a contract was also entered into between these two Companies providing for the sale of gas by the United Fuel Gas Company to the Warfield Natural Gas Company (R., p. 415).

The price fixed in this contract was 30 cents per thousand cubic feet at the point of delivery at the Big Sandy River. If it be assumed that this price of 30 cents per thousand cubic feet is a proper element for the Warfield Company to take into consideration in its rate schedule, then beyond question the price of 40 cents net prescribed in the rate schedule is no more than sufficient to pay the expenses of operation and give a fair return on the investment, and, of course, if the contracting parties were dealing at arm's length, the price which the Warfield Company paid for the gas would be the first element entering into the rate structure. It is contended, however, that because of the relationship existing between the Warfield Company and the United Fuel Company, the obligation rests upon the Warfield Company to justify this price of 30 cents and to show that it is a reasonable charge for the gas furnished to it by the United Fuel Company. Assuming the correctness of this contention, if it be shown that the price of 30 cents provided in the contract is a reasonable one for the gas sold by the United Fuel Company

to the Warfield Company, then the fact of their relationship, because of stock ownership, becomes unimportant.

City of Houston v. *Southwestern Bell Tel. Co.*, 259 U. S. 318; 66 L. Ed. 961.

State of Missouri, ex rel Southwestern Bell Tel. Co., v. *Public Service Com.*, 262 U. S. 276; 67 L. Ed. 981.

Indiana Bell Tel. Co. v. *Public Service Com.*, 300 Fed. 190.

In order to determine the reasonableness of the price fixed in this contract, it would of course be necessary to make an inquiry as to the value of the property of the United Fuel Gas Company, its expenses of operation and the receipts therefrom.

Such an inquiry was equally necessary upon the theory adopted by the Court below which is stated in its opinion, as follows:

> "In other words, it is conceded that as to the several parent companies and this subsidiary company, the gas may be considered as sold at whatever price may be determined to be reasonable, and the contracts and sales between such parent and subsidiary companies are to be disregarded in determining the reasonableness of the charges. As regards the complaints herein, the Warfield Natural Gas Company is to be considered the instrumentality of the United Fuel Gas Company, and the combined properties are to be regarded as a unit in determining the rate base." (R., 1568-9).

We proceed therefore to discuss the value of these combined properties.

The property of these companies may be divided into two classes: First, the pipe lines, compressor stations, distribution systems and wells, all used in the production and distribution of gas, which, for convenience, may be termed the "Physical Properties" of the Company; and second, the gas lands and gas rights owned by the Company, which, for convenience, may be termed "Gas Rights".

The Various Contentions as to Value.

Appellants maintain that the evidence shows a total value of their property, taken as a whole, as follows:

Physical property (production, transmission and distribution systems, etc.)	$22,274,274
Gas lands, leaseholds and rights	36,449,176
General overhead charges	6,357,046
Working capital	990,000
Going concern value (difference between reproduction cost new and same less deterioration)	8,423,105
Total	$74,493,601

Appellee's witness Hagenah testified to the following valuation (R., 1510-12, 910):

Physical properties (reproduction cost new, less deterioration, including natural gas lands, leases and rights at $6,732,920)	$27,045,784
Overhead (18%)	3,656,316
Working capital	990,000
Going concern value	3,000,000
	$34,692,100

While the Court below (R., 1580) reached the following conclusion:

Natural gas leases, book value	$6,732,920
Production, physical plant	7,830,400
Transmission	11,154,326
Distribution	2,694,806
General property	594,742
Overheads, 18% upon depreciable physical plant	4,009,370
Working capital	990,000
Going concern value	3,000,000
	$37,015,564

The Company employed the firm of Ford, Bacon & Davis to make an inventory and appraisal of its physical properties and plants. This appraisal was made under the direction and supervision of Mr. Charles F. Uebelacker of that firm. Mr. Uebelacker's evidence was taken and is reproduced in his exact language, under the order of the court below, beginning at page 796 of the printed record. He shows by his evidence his exceptional qualifications for the work in hand and the methods adopted by him in performing it (R., 797). So far as the physical properties are concerned, it may be said that he first went over the properties and made an exact inventory of every item of them, uncovering the pipe lines at such frequent intervals as to demonstrate their sizes and present condition. He also, in addition to making a list of the property, observed the condition of every item of it and noted this. He then applied present day prices to each item of the property and determined the cost of constructing the plant as a new plant. This inventory and appraisal was filed as part of his evidence, but no more is included in the printed record herein than the summary thereof, which will be found at pages 995 and following of the record. In addition to this summary, there were a number of volumes giving the inventory of the property and its valuation by separate items. The protesting cities thereupon employed an expert engineer, one W. J. Hagenah, who took the inventory made by Mr. Uebelacker and spent several months, with his assistants, in going over the property, with a view to criticizing the appraisal made by Mr. Uebelacker, but with the result that he found nothing whatever to criticise in the appraisal made, he testifying that in every instance the inventory checks which he made agreed exactly with those made by Messrs. Ford, Bacon & Davis; and further, that he made an extended study, over the entire history of the Company, to ascertain and determine the unit prices, and that in every instance he found the unit costs adopted by Mr. Uebelacker to be correct. (Printed record, pp. 907, 908). In view of this testimony upon the part of

the engineer expert employed by the defendants, it was not considered necessary to include the detailed inventories and appraisals as a part of the printed record, and only the summary thereof is included in the printed record, at pages 995 and following. Mr. Hagenah's report, corroborating the appraisal made by Mr. Uebelacker, is found at page 1507 of the printed record.

This appraisal shows that the cost of the property new, without including overhead charges or making any deductions for depreciation or including any allowance for working capital or going concern value, is $29,991,114. As to this amount there is no dispute. It was the result, as before stated, of a careful appraisal made by competent engineers, and carefully checked by competent engineers, employed for the purpose of detecting errors in it.

Gas Rights.

The principal controversy on the question of the value of the appellants' properties arises from the value to be assigned to the gas rights owned by them. It is shown that they own the gas rights in something over 800,000 acres of land, situate in southern West Virginia and eastern Kentucky. That a large part of this has been developed by the drilling of wells thereon, fully proving its character as productive of natural gas. The plaintiffs sought to prove the value of these gas rights by the introduction of evidence from expert geologists and engineers, as well as by the evidence of practical oil and gas operators of the largest properties of this kind in the United States. We will briefly call attention to the evidence contained in the record on this phase of the case.

Samuel S. Wyer, a Consulting Engineer of large experience, who has devoted his time largely to the ascertainment of the value of natural gas properties, made a careful examination for the purpose of arriving at such a value. It will

serve no useful purpose to detail his evidence. It is set out at pages 762 and following of the printed record. Relying on his knowledge of property transfers where similar leases were bought and sold, he valued the operated acreage at $300 per acre, and 20% of the reserve acreage at $100 per acre, excluding the remaining 80% entirely from his calculation (R., 764). He goes into the question fully and states at length how he arrives at his conclusions that the gas rights were of the value of $32,000,000. He declared, when testifying before the Commission, the gas fields owned by the United Fuel Gas Company to be the "most valuable natural gas property in the world (R., 456), and was confident that they could be sold in block at the price named by him (R., 458, 764).

Mr. Ralph E. Davis, a geologist and mining engineer of long and wide experience, made a careful study of all this property. His qualifications for doing the work appear in his testimony (R., pp. 822, *et seq.*). He was first employed by the appellant for the purpose of making a study of its gas properties for the purpose of calculating depletion under the Federal Income Tax Laws. The extent to which he gave attention to the question fully appears not only from his report, which constitutes Volume II of the printed record, but also from his oral testimony (R., pp. 822 *et seq.*). From these it appears that he made a study of all geological data available for the territory in which the lands lie. He then studied the records of all the gas wells drilled in the territory, not only those drilled by appellant but those drilled by other gas producers. He ascertained the original production of each well, the initial rock pressure thereof, the amount of gas produced from each well from the time it began producing gas until the date of his report, and likewise this same information as to each field or pool. He also observed the decrease in rock pressure in each well and in each pool as the gas was taken therefrom. He then observed the geographical location of each well, and studied the territory adjacent thereto, and from these observations determined the

number of acres of land proven to be productive of natural gas within each of the various pools which have been tested. Certain of the acreage he found to be so thoroughly tested and demonstrated to be productive of natural gas that he characterized it as "proven". Other portions of the territory he found to be practically demonstrated to be underlaid with, or productive of, natural gas, but because of some yet unascertained facts he did not consider them as fully proven as the acreage of the first class, and therefore classified them merely as "probable"; and in order to make allowance for the possibilities in regard to this acreage he, in making his calculations, deducted from its estimated gas content a percentage varying as to the different pools or tracts of land, but averaging as to all of them 38%. He gives definitions in his testimony and in his report as to what he means by the terms "proven" and "probable" territory (R., pp. 1172 and 1173).

His evidence shows that by "proven" territory he means such territory as had been actually proven to be productive of natural gas by wells drilled on it, and he does not consider anything as proven unless a well has demonstrated that fact. In the class of "probable" territory he classifies other acreage lying within what he finds to be the same pools, but upon which no wells have yet been drilled. The balance of the acreage held by the appellant he classifies as "possible" and "unfavorable", but he does not attempt to estimate or to determine the probable quantity of gas that would be derived from either, and has not included in his estimate any gas apt to be derived from these two classes. As to this latter acreage data were not available to permit of any reasonable estimate as to its value for natural gas purposes or as to the quantity of natural gas therein, for the reason that drilling had not so far progressed as to show whether or not it would be productive or otherwise.

Having determined by the method above indicated the number of "proven" and "probable" acres held by the appel-

lant, he next proceeded to determine the quantity of gas in the various pools. This he ascertained by comparison of the initial rock pressure and the rock pressure at the time he made the examination. By dividing the total number of cubic feet of gas produced from each pool by the decrease in rock pressure in pounds he ascertained the number of thousand cubic feet of gas produced from the pool for each pound of decrease of rock pressure. Then, by multiplying this factor by the initial rock pressure, he determined the quantity of gas in the pool originally and by multiplying it by the rock pressure at the time he made his observation he determined the amount of gas still remaining therein. The method pursued by him in reaching these conclusions, and the scientific basis therefor, fully appears in his report and in his testimony above cited.

To test the accuracy of these results he applied the same method to the past history of the various pools and wells (R., p. 1178). He found that by taking the decrease in rock pressure from the beginning up to 1913 and applying to it the number of thousand cubic feet which should according to his calculations have been produced for each pound of rock pressure he had a result which differed only about 6% from the amount of gas actually produced by the company during that period from those pools and wells, the actual production being in excess of the calculated production to that extent. This demonstrates both the reliability of his methods and the conservatism of his estimate.

It appears from Mr. Davis' testimony and report that the method adopted by him is one which is now generally approved for that purpose. It is the one used by the engineers of the United States Government in determining depletion for income tax purposes (R., p. 832). It is one relied upon by large gas interests (R., p. 833), and it has been applied for a sufficient length of time to actual conditions to demonstrate the practical value of it (R., p. 832). Mr. Davis finds that there is of what we have above termed

"proven territory" 136,384 acres, and in the classification above mentioned as "probable" territory, 126,208 acres, leaving 552,318.68 acres in the classifications mentioned above as "possible" or "unfavorable" (R., p. 1182); that there yet remains in the proven territory to be extracted therefrom 249,100,000,000 cubic feet of natural gas, and in the probable territory, 414,600,000,000, or a total of 663,700,000,000 cubic feet in these two classes (R., p. 1181).

In order to determine the value of the gas acreage or the gas rights of the appellant, appellant's witness Uebelacker, of the firm of Ford, Bacon and Davis above referred to, assumed the quantity of gas found by Mr. Davis to be available as correct. He then took several representative contracts under which gas was being sold in the field, in no wise affected by public regulation, and assumed that the Company's gas would be worth as much as the gas sold under those contracts, less what it cost the Company to produce it with its own wells. He made a very careful calculation of the cost of producing gas by the Company's own wells, and found that it cost 5.431 cents per thousand cubic feet. He took the various contracts above referred to and averaged the prices being received under these contracts at the well, and found that the value of the gas in the ground, using these contracts as a measure of value, was 5 cents per m. c. f. The method used by him is fully discussed in his report (R., pp. 1023-1038). Applying this to the total amount of gas which Mr. Davis found to be in the proven and probable acreage produced a value of this gas of $33,155,421.55 (R., p. 1038). The remaining acreage; to wit, 552,319, in respect of which Mr. Davis made no estimate as to the quantity of gas in the ground, Mr. Uebelacker valued at the average price for acquiring acreage in the year 1923, to wit, $5.9635, per acre, giving to this acreage a value of $3,293,754., or a total valuation for land, leaseholds and natural gas rights of $36,449,176., which is the first item carried into his table at page 1040 of the Record. The contracts which Mr. Uebelacker took as

typical were, as appears from his report above referred to, entirely independent contracts for the sale and purchase of large quantities of natural gas made by parties dealing at arms length and without the intervention of any public regulating authority.

Ira G. Sayre, an independent producer, testified (R., p. 843), that he was selling the gas produced by him to the Owens Bottle Company, after extracting the gasoline, at 10 cents per thousand cubic feet, and that he had made other sales at from 12 to 15 cents per thousand cubic feet; that the contract was made with the Owens Bottle Company about three years before he was testifying; that the price of gas had not decreased since, and that he did not expect to renew said contract at that price when it expired.

H. A. Wallace, Vice President and General Manager of the appellant, testified (R., p. 845) that during the last year before he testified he made contracts to purchase gas from small producers in the field; that under the last contract he recalled he paid 15 cents a thousand for the gas at the wells, and agreed to spend approximately $120,000 in laying pipe lines, and gave to the party with whom he contracted what he considered approximately 1,000 acres of proven gas or oil territory.

The testimony of these witnesses demonstrates the correctness of the figure arrived at by Uebelacker, and in fact shows that he was decidedly conservative in fixing the value of the gas in the ground.

In addition to these valuations arrived at by Mr. Uebelacker and Mr. Davis in the manner above detailed, the appellant produced a number of men prominent in the natural gas business because of their long experience therein and the magnitude of the business done by the companies with which they were connected, as well as because of their peculiar knowledge of the gas fields in which the United Fuel Gas Company's acreage was located, who made independent valuations of this natural gas acreage.

The evidence of T. O. Sullivan (R., pp. 780, *et seq.*) shows that at the time he testified he was vice president and general manager of the Hope Natural Gas Company. He showed his connection with large producing natural gas companies in West Virginia and Western Pennsylvania over a long period of years. He stated that he had access to and examined all of the records of the United Fuel Gas Company pertaining to its production of natural gas, and also showed his entire familiarity with the territory; that he was familiar with the extent to which it had been drilled and tested; that he knew the acreage controlled or owned by the United Fuel Gas Company; knew the number of wells drilled and the production of each well, and that from the data and information he had he was in a position to enable him to have and express an opinion as to the value of this territory. He stated that in round numbers it was $34,000,000; that in his judgment the operations carried on upon the property had been very wisely conducted to the end of developing the property to the greatest extent with the fewest number of wells; that he had operated similar properties for the last twenty years; that the United Fuel Gas Company is a peculiarly valuable property because of the fact that the acreage is well joined up, enabling it to produce the gas at a minimum cost because of the non-necessity for drilling offset wells and the absence of interference from outside producers. This witness further testified that the valuation he gave to these gas properties was considering the sale of the gas in a free market where the price would not be affected by the rates prescribed by public authorities, such markets existing in Ohio and Pennsylvania; that in fixing his value he did not consider any value which the gas might have for the extraction of gasoline, and that if the gas has any additional value for this purpose, that fact would increase his estimate to that extent; that he is familiar with the plant of the United Fuel Gas Company, and that in his judgment the amount of acreage which it has is not any too much; *that a company would not be justified in making*

such an investment as has been made in appellant's plant without a large reserve acreage, in fact, that the acreage already held is not enough if other desirable acreage can be secured; that the Hope Natural Gas Company, of which he was general manager, purchases gas in the field at prices ranging from 10½ to 18 cents.

John B. Corrin testified (R., p. 785), that he was the Vice-President of the Hope Natural Gas Company. He showed the connection that he has had with the natural gas business for a long number of years, and his connection with large operating companies such as the appellant in this case; that the company with which he is connected has approximately 900,000 acres of territory, and approximately 3,100 live wells. He also detailed his connection in the past with other companies. He testified as to his familiarity with the properties of the United Fuel Gas Company; that a large part of it was formerly held by the Hope Natural Gas Company, and transferred by it to the United Fuel Gas Company, and for that reason he was particularly familiar with this part of it; that he had studied all of the elements that entered into forming a judgment as to the value of such property, having had access to all of the Company's records, and knew the number of wells, the amount of gas produced, the initial rock pressures of the wells, present rock pressures, as well as all other information which he considered material; that in his opinion the gas rights of the appellant were worth $35,000,000, assuming that the gas can be sold in a free market, uncontrolled by any public authority, and that there is no doubt that such a market exists in Ohio and Pennsylvania. He detailed in his evidence at length the reasons he has for fixing this valuation, and testified that he knew the plant of the United Fuel Gas Company; *that the construction of such a plant would not be justified unless the company constructing the same had behind it at least as much reserve acreage as appellant has and that the acreage held by it is no more than sufficient.*

T. B. Gregory testified (R., p. 791) as to his connection with the natural gas business. He also showed in his testimony his familiarity with the properties of the United Fuel Gas Company, and valued the same at not less than $30,000,000. That he would unhesitatingly recommend the purchase of the gas rights for that sum (R., p. 793). Mr. Gregory also showed that he was familiar with the character of title by which the Company held its gas rights, and that *it would be necessary to have as much territory as the appellant owned, or more if it could be procured, in order to construct and finance such a plant as it had.*

In addition to the evidence of the three witnesses last named, none of whom was connected with or interested in appellants, the attention of the Court is respectfully invited to the very clear and circumstantial testimony of H. A. Wallace, Vice President and General Manager of the appellant United Fuel Gas Co., at R., 773-9. His valuation of the gas producing property of the appellants on an acreage basis is from $40,000,000 to $40,500,000 (R., 774).

To meet this testimony as to the value of the gas rights and properties, the appellee, introduced *nothing* except the evidence of the amount paid by the Company for the acreage in the beginning.

It must be borne in mind that the evidence of the value of this property which the court below considered as the only competent evidence thereof is its cost long before the rise in prices and at a time when development had not proven the value of the territory for natural gas production. This evidence is the evidence which this Court has so recently said in *McCardle* v. *Indianapolis Water Company*, 272 U. S. 400, 410, is of little weight in determining the question of value. The Court in that case said that the cost of a plant or the cost of property acquired prior to the great rise in prices due to the war does not constitute any real indication of the value of the property at the present time. We submit that instead of taking the most reliable evidence as to value, the Court

below attributed exclusive weight to the least reliable evidence thereof. Upon this theory that the cost of the gas rights was the proper evidence of value, the court below fixed a value of $6,732,920 therefor. No contention is made by any of the experts for the appellees that this is anything like the present value of the property. Indeed, the appellees have not undertaken to present any evidence as to its present fair value aside from the actual cost thereof, but contend, first, that the evidence introduced by the appellant is of such an indefinite character as not to be worthy of consideration, and therefore no weight should be given thereto; and, secondly, that even if these gas rights and reserves are of the value shown by appellant, they are not all used and useful in the public service at the present time.

The question of the value of such natural gas rights for rate-making purposes was involved in *City of Erie* vs. *Public Service Commission of Pennsylvania*, 278 Penn. 512, 123 Atl. 471. In that case the owner of the property sought to fix a value in excess of the amount paid for the gas rights. It offered evidence similar in character to the evidence introduced in this case (123 Atl. at p. 477), the testimony of its witnesses fixing the value in excess of $11,212,000. The Public Service Commission of Pennsylvania fixed a value of $5,000,000. Commenting upon the action of the Commission in declining to give consideration to the evidence in arriving at the value, the Supreme Court of Pennsylvania said (123 Atl. at p. 477):

> "The Commission, in valuing the gas holdings, stated: 'Taking into consideration the total holdings of the respondent, with all the testimony bearing on their present value, we are of the opinion that the used and useful portions attributable to Pennsylvania should be included in the rate base at $5,000,000.00.'
>
> The lowest value under the evidence was $11,212,000.00. It is apparent, from what the Commission said, they proceeded on an erroneous conception of the evidence. Much, if not all, of the same testimony would

> have been admitted as evidence of market value in condemnation of the same land. No attack was made on the competency, sufficiency or credibility of the witnesses to establish the fact of general market value."

The same Company had the question of the valuation of its properties involved in the State of New York, and the Public Service Commission of that State declined to fix the value in accordance with the evidence, which was similar to the evidence introduced in the Pennsylvania case. The question came before the Appellate Division of the Supreme Court in *Pennsylvania Gas Company* v. *Public Service Commission*, 211 App. Div. 253, 207 N. Y. Supp. 599, where the action of the Public Service Commission was reviewed. In speaking thereof, the Court said (211 App. Div., p. 262):

> "The criticism by the Commission concerning the reliability of rock pressure measurements to determine present gas contents and to foretell duration thereof is not based, so far as we can find, upon any evidence in the record which impeaches the accuracy of petitioner's records or the credibility of its witnesses as to those particular gas fields of the petitioner. The determination must be a reasonable determination based upon the testimony and the records in the case. The Supreme Court of Pennsylvania has recently passed upon the identical records and testimony contained in the record before us in relation to the value of petitioner's gas fields, with the exception that the Company presented two additional witnesses in the New York case."

And after quoting from the opinion of the Pennsylvania Court the passage which we have quoted above, the New York Court further proceeds (211 App. Div. 262-3):

> "The proofs show that these gas lands have a market value as lands as a whole or per acre and are not subject to the criticism that they were opinions as to value based upon the sale price per cubic foot of gas. Taking the lowest value given by these witnesses, $11,212,000.00, and allocating 26.8 per cent to New York, we find $3,

004.816.00 to be the lowest amount distributable to New York upon the basis of this evidence. The maximum claimed by the Company is $12,000,000.00 with $3,216,000.00 allocated to New York, as found by the former Commission. The present Commission has allocated into the New York rate base only $2,000,000.00.

"We do not see how the Commission has fixed the value without disregarding the reasonable effect of petitioner's records and testimony as to the present market value of its gas lands."

This case was later approved by the same Appellate Division in *People* ex rel. *Peoples Gas & Electric Co.* v. *Public Service Commission*, 214 App. Div. 108, 211 N. Y. Supp. 662, 664, in which opinion the Court said (214 App. Div. at pp. 112-13):

"The city's expert witness was competent to express an opinion as to reproduction cost, had he desired to do so. Instead thereof by means of some vague theory called 'normal reproduction cost,' which the Commission itself has properly described as substantially only original cost, he designedly or otherwise evaded the issue. The difficulty is that the city permitted this branch of the case to go by default. We are, therefore, justified in concluding that the evidence of the petitioner on this branch of the case is substantially correct and the authorities cited require us to hold that it is of dominating importance in the absence of evidence destroying or substantially weakening its effect."

True, the Supreme Court of Appeals of West Virginia in *City of Charleston* v. *Public Service Commission* (95 W. Va. 91, 120 S. E. 398), involving the same property, held that the evidence before it in that case was too speculative and uncertain to base a judgment of value upon. Attention is called, however, to the fact that the Court of Appeals of West Virginia had no such evidence before it in that case as was given in this case by the witnesses Sullivan, Corrin and Gregory, nor was the evidence of Mr. Davis as full and cir-

cumstantial, or supported by the testimony of Mr. Uebelacker. It also appears that the method of arriving at the estimate of the quantities of gas in the ground had not at that time been so well established and proven as it was at the time of this inquiry (R., p. 833).

Judge Hickenlooper (R., p. 1577) criticizes the evidence of value of appellant's gas properties introduced on the ground that this class of the Company's property consists principally of leaseholds and the evidence is directed to the value of the gas in the ground and not to the value of the leaseholds, and that there is no evidence of the value of these leaseholds except on the basis of capitalizing earnings (R., p. 1577). This criticism entirely loses sight of the testimony of Wyer, Sullivan, Gregory and Corrin. All of these witnesses were placing a value upon the particular leaseholds that appellant owned and on nothing else, and they showed by their testimony that they were fully acquainted with the exact interest that appellant had in the property. The values fixed by these various witnesses, using different means of arriving thereat, range from $30,000,000 to $35,000,000 for these gas rights.

We submit that there is no justification for rejecting all of the undisputed evidence and fixing the value as the lower court did, at the actual cost; to wit, $6,732,920 (R., pp. 1577-8).

The witnesses introduced were all thoroughly familiar with the business, and competent to testify upon the questions presented to them. With one exception, they had no connection with the appellant. The strongest evidence of the fairness of these witnesses is the fact that no attempt is made to controvert their evidence. If the appellees had been able to find any witnesses whose testimony could have tended to weaken or discredit that of these witnesses of appellants, it is unthinkable that such witnesses would not have been called.

The testimony of witnesses cannot be arbitrarily discarded; there must be some basis in the record to justify discarding it, and we submit that there is no such basis.

We have in this case the situation of testimony offered which would be perfectly competent to prove the value of this property if the same were sought to be condemned for any public purpose, or to prove the value of it for any other purpose for which it might be necessary to determine the same, but it is urged that some other or different character of proof must be offered when we come to show the value for rate-making purposes. It is not suggested what character of proof could be offered different from or additional to that which has been presented. The Court will understand that a reliable opinion as to the money value of such property as appellant's gas holdings is scarcely to be had except from those interested in the same business. As is pointed out herein, appellees offered no direct evidence as to the value of the gas properties, but the rate base arrived at by their witnesses shows that they did not give any weight to appellant's uncontroverted testimony. The devotion of private property to the public service for compensation fixed by a public rate-making body is in the nature of the exercise of the power of eminent domain, and we undertake to say that the same sort of evidence which would be competent to prove its value in a proceeding to take it for public use is competent and sufficient to prove that value in an inquiry directed to ascertaining its value for rate-making.

Fourth.

The court erred when arriving at the value of plaintiffs' plant in not making proper allowances for interest during construction, cost of financing and overhead charges.

In arriving at the value of appellants' physical property for the purposes of this case, the court below rejected most of the theories upon which the appellants' expert acted, and adopted those of the expert engineer offered by the appellees.

In most cases of this character involving many items of property, there are generally several valuations by different engineer experts, and as a rule they do not agree as to the value of the various items going to make up the whole property, or as to the value of the same as a whole. In the instant case, however, while the property has been valued or appraised by engineer experts employed by both sides, there is no disagreement as to the items of property making up the plant or as to their value new, the only disagreement being as to theories of appraisal and elements of value.

The appellants' witness Uelselacker, having completed the inventory hereinbefore mentioned (p. 27), added to the cost of the property new ($29,991,114) certain overhead charges and an allowance for working capital, and found that the cost of reconstructing the plant new, exclusive of the gas rights or properties (calculated by him at $36,449,176), would be the sum of $38,044,425 (R., Tables, pp. 1039-40). In this valuation there was included an item of $990,000 for working capital, but nothing for the element of the going concern value. Mr. Uelselacker next determined from his examination the extent to which each item of the property had depreciated or deteriorated, and found that after deducting for this deteriorated condition of the property it was worth the sum of $29,621,320 (R., Table, p. 1040), exclusive of going concern value. The inventories and appraisements made by Mr. Uelselacker consisted of four or five large volumes, and detailed conclusions are embraced in a summary thereof filed with this testimony as Exhibit No. 1, found at pages 995 and following of the printed Record. This total of $29,621,320 is made up of $10,127,919* invested in gas producing wells, $14,424,364, in transmission systems

*Which is ascertained by deducting from the total deteriorated value of the production system, shown in column two of the totals at Record, page 1040, as $46,577,095, the value of the lands, leaseholds and gas rights, shown in the same column of the same table as $36,449,176.

consisting of gas lines and compressing stations, $3,349,509 in distributing lines for conveying gas to consumers in the cities and towns served by the appellant, $729,528 in general property consisting of its office building and other properties not readily attributable to any of the particular systems, and $990,000 working capital (R., pp. 1040-1-2). It will be observed that Mr. Uebelacker's deteriorated value of the property is less by more than $8,000,000 than the cost of reproduction new as found by him.

W. J. Hagenah was employed by the appellees for the purpose of making a valuation of the Company's property, or, as he states in his evidence, for the purpose of checking Mr. Uebelacker's valuation and criticizing it (R., p. 907). He spent several months with a corps of assistants in this work and found Mr. Uebelacker's inventory and appraisal absolutely correct, so far as the items of property were concerned and the value to be attributed to each item, but disagreed with Mr. Uebelacker as to certain allowances for overhead charges, and as to the method of calculating depreciation upon certain kinds of property. (See his report, R., p. 1507.) Because of this agreement between the engineers valuing this property, it was not deemed necessary to include in the printed record any more than a summary of the inventory and appraisals. Mr. Hagenah finds the value of the Company's property undepreciated to be $43,114,072, in which is included $6,732,920. for value of the gas leaseholds and gas rights. Deducting the latter item from his total valuation, there remains $36,381,152 as present reproduction cost of the physical property. It will be observed that this is $1,663,273 less than the value found by Mr. Uebelacker. (See Mr. Hagenah's Table, pp. 1510-12 of the printed Record). This difference does not arise because of any disagreement between these witnesses as to any matter of fact, but simply as to the question of proper allowances to be made for general overheads. Overhead charges are necessarily a mat-

ter of estimate, and not dependent upon proof of actual expenditures originally made.

Ohio Utilities Co. v. *Public Service Commission of Ohio*, 267 U. S. 359, 362; 69 L. Ed. 656.

Mr. Hagenah approves all of the allowances made by Mr. Uebelacker for general overheads in his appraisal with the exception of the item of financing amounting to 4% and that of interest during construction, which he says should be 7% instead of 8%, as allowed by Mr. Uebelacker (R., pp. 960-1). It would seem that the fact that these two engineers absolutely agree on every item of the valuation of the property after an exhaustive investigation extending over many months should be conclusive of the question. It appears from Mr. Hagenah's testimony that he had Mr. Uebelacker's inventory and appraisal at the time when he made his inspection and examination, and that after very carefully comparing them with the property found by him, he was unable to criticize the same in any respect except as to the item of overhead charge above referred to and the theory of depreciation which he advanced as to certain items of the property (R., p. 949). These, of course, are purely matters of theory.

As to the cost of financing, Mr. Jirgal, appellee's witness, maintains that this item as estimated by Mr. Uebelacker is nothing more than bond discount, which, under what he says is a proper system of accounting, should be amortized over the life of the securities (R., pp. 881-2). Mr. Hagenah (R., p. 909) takes the same position. But Mr. Uebelacker, both in his report (R., p. 1022) and oral testimony (R., pp. 801-2) makes it very clear that this item has no reference to discount upon securities, and "must not be confused" therewith. It is simply the "expense of assembling the necessary capital for the enterprise", including "the expense of distributing the securities to the public". This is unquestionably an inevitable incident of financing any undertaking requiring any considerable amount of capital.

Re Utah Power & Light Co. (Utah), P. U. R. 1922-A, 436;

Re Utah Light & Traction Co. (Utah), P. U. R. 1920-B, 262;

Philadelphia vs. *Philadelphia Rapid Transit Co.* (Penna.), P. U. R. 1923 E. 190;

Alpha Portland Cement Co. vs. *Lehigh Navigation Electric Co.* (Penna.), P. U. R. 1924 E. 737;

Ben Avon Borough vs. *Ohio Valley Water Co.*, 271 Pa. 346, 114 Atl. 369, P. U. R. 1921 E. 471.

With regard to the item of interest during construction, 8%, Mr. Uebelacker in his testimony states that he bases his figures on actual experience (R., pp. 802-3), and that the figures he uses are deduced from actual expenditures for these items in the construction of similar plants to those employed here; while Mr. Hagenah gives it as his opinion that 7% would be sufficient for interest, but states that he never had any experience in the construction of such a plant, and does not base this estimate upon any experience. So that we have on the one hand a conclusion drawn from actual experience as against an opinion on the other hand with no experience behind it (R., p. 960).

An examination of Mr. Hagenah's table above referred to shows that he finds the total value of the property, after deducting for depreciation, to be $31,692,100 (R., pp. 1510-11-12), in which is included the item of $6,732,920 as the value of the gas rights. Deducting this item, we have a total of $24,959,180 as the present fair value of the physical property after deducting depreciation, as compared with $29,621,320 as found by Mr. Uebelacker, or a difference of $4,662,140. A part of this difference is accounted for by the difference in overhead charges above referred to. Nor does the remainder of it exist because of any disagreement upon matter of fact, but simply because of difference in theory. Mr. Uebelacker, in arriving at the present value of the property, observed

its actual condition, and fixed a value upon it upon that basis. Mr. Hagenah does not criticise the conclusions reached by Mr. Uebelacker if this basis be established. He contends, however, that this is not the correct basis for computing depreciation in this instance, but that the latter should be computed upon what is termed the "straight line" basis,—that is, the allowance of a certain uniform percentage each year during the life of the property or such parts of the property as will outlast the gas field. It thus appears that there is upon this question simply a difference in theory between the experts.

The language used by this court in the case of *Pacific Gas & Electric Company* v. *San Francisco*, 265 U. S. 403, is in point here. Speaking of the calculation of depreciation by the "modified sinking fund method," the Court says (p. 406):

> "Appellant objects to the application of this method and insists that depreciation should have been ascertained upon full consideration of the definite testimony given by competent experts who examined the structural units, spoke concerning observed conditions and made estimates therefrom. As these examinations were made subsequent to the alleged depreciation for the definite purpose of ascertaining existing facts, we think the criticism is not without merit. Facts shown by reliable evidence were preferable to averages based upon assumed probabilities. When a plant has been conducted with unusual skill, the owner may justly claim the consequent benefits."

We submit that the evidence based upon actual experience requires the adoption of the theories of Mr. Uebelacker and leads to a valuation of the physical plant, less deterioration, of $29,621,320, being the amount shown at Record, page 1039, less the amount included therein for leaseholds

Working Capital.

Another item entering into consideration in determining the value upon which the appellee is entitled to a return is that of working capital. All parties agreed that the amount of $990,000 is proper for this purpose.

Fifth.

The Court erred in refusing to allow any more than $3,000,000 for going concern value.

That there is an item of value which the witnesses and others term going concern value inhering in this property is admitted by all parties. This item of value is recognized by this Court in many decisions, among others,

City of Knoxville v. *Knoxville Water Company*, 212 U. S. 1;

Des Moines Gas Co. vs. *Des Moines*, 238 U. S. 153;

McCardle vs. *Indianapolis Water Co.*, 272 U. S. 400.

That the plant of the United Fuel Gas Company is in a high state of efficiency for performing the functions for which it was intended is fully proven by the evidence, and, in fact, uncontroverted. Mr. Hagenah, the engineer expert for the appellees, fully recognizes this (R., p. 910).

There is, however, a difference of opinion between the experts as to how much should be allowed for it. Mr. Hagenah testified as his opinion that 10% of the value of the property would be a proper allowance for going concern value, and upon the assumption that the property was worth $30,000,000 in round numbers, he fixed $3,000,000 as the going concern value. Of course if the value of the property is found to exceed $30,000,000, then the going concern value upon his theory would necessarily be increased, as the basis of his opinion is upon 10% of the value of the property (R., p. 910).

Mr. Uebelacker on the other hand was of the opinion that the going concern value is the difference between the present depreciated value and the cost of construction new, and gave as his reason the fact that the plant is in a condition to render 100% service and does render 100% service, and that this difference in value between a connected plant fully operating with an efficient organization and with the advantage of years of experience in such operation, and a new plant not yet in operation, is sufficient to equal the difference between the deteriorated value of the items of property that go into it and the new value of such items of property (R., pp. 806-7-8); that is, as to functioning power the plant had not deteriorated.

We commend this view to the Court as entirely reasonable. This Court has recently, in *McCardle* vs. *Indianapolis Water Company*, 272 U. S., 400, p. 415, expressed the opinion that under the decisions which it cites, 10% of the value of the physical element would be *low* as an allowance for going value when the "impressive facts" reported in that case were taken into account. It is confidently submitted that the facts disclosed by the record in this case are at least equally impressive in this connection. If, however, the Court inclines to the opinion that Hagenah's estimate of 10% rests upon a sounder basis, that rate will necessarily have to be applied to the increased rate basis if the Court sustains appellants' contentions hereinbefore discussed as to the overhead and other items.

Sixth.

The Court erred in holding that depletion and amortization could be amply provided for by an allowance of 4½% of the depreciable and depletable rate base, and 1½% to meet charges for depreciation, repair and replacement.

The court below, in its opinion, concluded that, regardless of the present value of the property, the amortization or

depletion fund should only be calculated on actual cost; in other words, this fund which is provided to return to the owners of the property its value at the end of its life need only be sufficient to return to them what they paid for it, regardless of its value; that the return on the investment should be calculated upon the actual present value, and that the fund provided for depreciation—that is, the fund to keep the property in working condition, should be calculated upon present value.

We challenge the former of these propositions. This amortization fund is for the purpose of returning to the stockholders of the Company the value of their property when it is consumed in the public service. A large part of this value is made up of the gas in the ground. The other part is made up of the plant constructed for the purpose of producing this gas and transporting it to the consumer. If, because of enhanced values of the various properties going to make up the plant used for producing the gas and transporting it, it is worth more now than it was when it was constructed, we can conceive of no reason why it should not be paid for at its value at the time the payments are made. While it is the same property, it is true, still, as the witnesses have stated, the difference in cost is not because of the difference in the property, but the difference in the purchasing power of the dollar. If the purchasing power of the dollar has decreased as compared with the time at which the plant was constructed, and the value of the plant measured in dollars has correspondingly advanced, then when the stockholders are paid the money from time to time to take the place of the plant or to compensate them for the consumption of the plant in performing its work, they should be paid a sufficient amount in excess of what the plant cost when it was installed to make the money which they get of the same value as the money they put into the plant. This same thing is true as to the gas that is used, except in a much larger measure. The gas territory was acquired when the possibilities

were unknown, and, of course, after millions of dollars have been spent in the demonstrating that this territory is valuable gas-producing territory, it is worth much more than it was before this expenditure was made, independent of any deflation of the currency, and the stockholders of the Company are entitled to have back the value of the gas at the time it is taken and paid for and not what was paid for the territory before it was known that it would be productive of natural gas.

An illuminating case on this question, is that of *Michigan Public Utilities Commission* v. *Michigan State Telephone Co.*, 228 Mich. 658, 200 N. W. 749. That was a mandamus application brought for the purpose of compelling the Telephone Company to observe a rate prescribed by the Public Utilities Commission of Michigan. The Telephone Company responded that it ought not to be required to observe the rate because the same was confiscatory, and asserted, among others, as the reason for this contention, that allowances for depreciation and amortization were made upon book or investment costs instead of upon present fair value. The court, in discussing this question, said (200 N. W. at p. 752):

> "Computing depreciation (although perhaps convenient to accountants and bookkeepers), on investment cost, or book cost, as distinguished from present fair value, must be rejected. If the rate base is present fair value, then the depreciation base as to depreciable property is the same thing. There is no principle to sustain a holding that a utility may earn on the present fair value of its property devoted to public service, but that it must accept and the public must pay depreciation on book cost or investment cost, regardless of present fair value. We repeat, the purpose of permitting a depreciation charge is to compensate the utility for property consumed in service, and the duty of the commission, guided by experience in rate making, is to spread this charge fairly over the years of the life of the property."

Of course, the fair way to provide for amortizing the property is to do it upon the basis of assigning or alloting

to each unit of gas a certain sum for amortization. Amortizing it over a period of eighteen years is on the assumption that production in the future will continue at the same rate as in the past. There is really no basis for this assumption. It may be greater or it may be less. If, however, we amortize the property upon the basis of attributing to each thousand cubic feet of gas its proportional part of all of the property, then it makes no difference what period is taken as the life of the property, for, whether it be consumed in five years or twenty years, its value will be returned just as it is consumed.

If, then, we take $74,493,601 as the value of the property and 663,700,000,000 cubic feet of gas as the quantity of gas to be produced and transported, we have, in effect, a figure in excess of 10 cents to be taken into consideration as the amount necessary to pay for the gas and the plant used in its production and distribution. If we take 8% per annum upon the value of the property as a fair rate of return, it would require $5,959,488 to provide a fund for this purpose, and if we consider that 1½% of the physical property and overheads for depreciation is a sufficient amount therefor, a fund of $429,470 per year must be provided for that purpose; or, for return on the investment and depreciation fund, a total of $6,388,958 per year. If we assume that the future production will be the same as it was in 1923, and this is the assumption upon which the court's opinion is based, to wit, 37,370,482,000 cubic feet, it would be necessary to provide a fund of $3,737,048 for the purpose of paying for the gas and amortizing the plant at the rate of 10 cents for each thousand cubic feet, or for the purpose of providing for the amortization of the property, depreciation and return on the investment, a total of $10,126,006 per year.

Mr. Jirgal, the expert accountant for the protesting cities, at page 1409 of the printed record, has made up a table adjusting earnings and expenses in accordance with his conten-

tions, and finds that the net earnings of the Company are $5,882,222.47 as adjusted by him, or $4,307,719.72 as shown by the books of the Company; or if he adds one-half of the gasoline earnings for the year 1923, a total of $6,504,270.24, applicable to return, depreciation and amortization, or more than $3,500,000.00 less than the amount required for that purpose. This shows that the Company is not making enough to produce a fair return on its investment after providing for expenses and depreciation and amortization of its plant.

Seventh.

The Court erred in including in the earnings of the appellants one-half of the net earnings from the extraction of gasoline by the Virginian Gasoline and Oil Company.

It appears that Virginian Gasoline and Oil Company is a corporation, all the stock of which was held by the same parent companies that held the stock of appellant and in the same proportion. Appellant made a contract with the Virginian Gasoline and Oil Company to extract the gasoline from the natural gas produced by the former (R., p. 760). It further appears that by the extraction of this gasoline, the gas is made more suitable for transmission in that there is eliminated from it those liquid particles which might be left in the transmission lines with the effect of holding up the transmission and attacking the rubber in the joints (R., pp. 275-6).

Under this contract appellant receives from the Virginian Gasoline and Oil Company a royalty of one-eighth (1/8) gross of all the gasoline produced by it from this gas and this one-eighth royalty has been regularly paid and accounted for in the statements introduced by the appellant. The appellees' witness Jirgal was of the opinion, however, that this did not give to the Gas Company a sufficient return for the privilege of extracting the gasoline, so he arbitrarily added to the Gas

Company's earnings one-half of the net earnings from the gasoline.

Appellees assert that inasmuch as this contract was between parties so closely allied, it cannot be taken as a true measure of the value of the privilege of extracting the gasoline and the Court (R., p. 1581) took this view and found that one-half (½) of the net earnings derived from the production of the gasoline should be included in the earnings.

While it is true that the contract between the appellant and the Virginian Gasoline and Oil Company is, as before stated, between closely affiliated organizations, we submit that there is none the less a presumption that the contract is fair and that its terms should be enforced unless this presumption of fairness is rebutted by the proof. (*Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U. S. 276). The weight of evidence is to the contrary. Thus the appellants' witness Wallace (R., 777) declares the contract fair, and (R., 845) that at the date of his testimony before the Court this one-eighth royalty exceeds the entire profits from the manufacture of gasoline. And the witness Uebelacker (R., 817) thinks a royalty of one-eighth gross a better contract than one for one-half the net profits. The only evidence in the record that in any way might suggest that this contract is anything but fair is that of the witness Krebs (R., pp. 972, *et seq.*). This evidence shows that his experience has not been very large and is perhaps limited to an actual knowledge of but one contract made upon the basis adopted by the Commission in this case, as to which it further appears that the party making this contract became insolvent and unable to carry it out (R., p. 974). Said this witness: "I have known of different royalties being paid under arrangements of that kind, in some cases one-fourth, one-third, and in some cases one-eighth" (R., 974).

But even if it be considered that one-half of the net profits derived from the gasoline business is a fair consideration for the privilege of extracting this gasoline, we submit that it

was not proper to take the net earnings of the year 1923 as typical. It appears that this year 1923 was an exceptional one. The gasoline earnings for the year 1924 are shown by months in Hightower Exhibit Z, (inserted between pages 994 and 995 of Record) and the total for that year in Jirgal Exhibit No. 9a (R., p. 1505). It will be noticed from this latter exhibit that for the year ended December 31, 1924, the net gasoline earnings were $1,066,110.32 as compared with $1,868,786.82 for the year 1923 (R., p. 1412). This very substantial decrease in the earnings from gasoline is accounted for by the fact that during the early part of the year 1924, a new process known as the "cracking process" was put in common use for the extraction of gasoline from crude petroleum which resulted in obtaining more than twice the quantity of gasoline that was formerly obtained from the same quantity of oil; and, inasmuch as the quantity of gasoline produced from natural gas is less than 10% of the total production of gasoline, the remainder being from crude petroleum, the price was necessarily controlled by the cost of producing from crude petroleum. (Testimony of Mr. Jirgal, R., pp. 888 *et seq.*).

Mr. Hagenah expressed the opinion that the price of gasoline was only temporarily depressed. Gasoline is an article of such universal use and the price so generally known that the Court no doubt will take judicial notice of the fact that Mr. Hagenah's prophecy has not up to this time been fulfilled.

Eighth.

The Court erred in holding that the rates fixed by the Railroad Commission of Kentucky were not confiscatory.

If appellants are correct in their principal contentions as to the value of their gas properties, and that the whole of such value must be included in computing any rate base, a

simple though somewhat rough calculation will show that even if the findings of the lower Court be taken upon every other item of property, the existing rates are confiscatory by a wide margin.

We illustrate this by assuming a rate base and net income from the property assigned to the Public Service in Kentucky and a rate of return on the theory that the lower Court was correct as to all questions of value, except as to the value of the gas leaseholds.

Hypothetical Rate Base.

The lower Court found the total value of the property to be $37,015,564, in which is included the item of $6,732,920 as the value of the gas properties which leaves for the value of what we have called the physical properties, going concern value and working capital (R., p. 1580) the following:

Physical Property	$26,283,644.
Going Concern Value	3,000,000.
Working Capital	999,000.
Total	$30,282,644.
Add to this the lowest valuation of the gas properties fixed by any of Appellant's witnesses in the gas business	30,000,000.
TOTAL	$60,282,644.

Appellants' witness Uebelacker's table (R., 1039) shows the value of all the property as $65,080,496, and that of the portion allocable to Kentucky as $7,156,357.

or 11% of the total value of the property.

The experts for the appellees do not disagree substantially with these figures. If the value of the property is taken to be... 60,282,644.

instead of the amount found by Mr. Uebelacker, then the proportion assignable to the Kentucky business would be 11% of that amount, or by items as follows:

Physical Property	$2,891,201.
Going Concern Value	330,000.
Working Capital	109,890.
Leaseholds	3,300,000.
	$6,631,091.

The witness Jirgal (R., 1424) filed a table which shows after adjusting all earnings that there is available for depletion, depreciation and return from the Kentucky business | 749,839.

The Court below has found that 8% is a fair return, and that 1½% and 4½% are fair allowances for depreciation and amortization respectively (R., 1583). Applying these percentages to the property allocated to Kentucky as above, we find that the following sum would be required:

Amortization @ 4½% (on total less working capital)	$293,454.
Return @ 8% (on total)	530,487.
Depreciation @ 1½% (on physical property)	43,368.
Total	$867,309.

to produce the above percentages set by the Court upon our hypothetical rate base of $6,631,091.

While according to Mr. Jirgal's calculations aforesaid there is only | 749,839.

available for the purpose, after increasing the actual earnings by a number of adjustments, leaving a shortage of | 117,470.

or practically 15.67% less than a fair return.

Ninth.

The judgment of the District Court should be reversed and this cause remanded with appropriate directions.

Respectfully submitted,

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(3)

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In the

Supreme Court of the United States

No. [redacted] 1

UNITED FUEL GAS COMPANY, a corporation, and WARFIELD NATURAL GAS COMPANY, a corporation,

Appellants.

BRIEF FOR APPELLEES.

Vs.

THE RAILROAD COMMISSION OF KENTUCKY, FRANK N. BURNS, OSCAR VEST, AND ISAAC WILDER, members of and constituting said THE RAILROAD COMMISSION OF KENTUCKY, and FRANK E. DAUGHERTY, Attorney General of the State of Kentucky,

Appellees.

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In the

Supreme Court of the United States

No. 19

UNITED FUEL GAS COMPANY, a corporation, and WARFIELD NATURAL GAS COMPANY, a corporation,

Appellants.

BRIEF FOR APPELLEES.

Vs.

THE RAILROAD COMMISSION OF KENTUCKY, FRANK N. BURNS, OSCAR VEST, AND ISAAC WILDER, members of and constituting said THE RAILROAD COMMISSION OF KENTUCKY, and FRANK E. DAUGHERTY, Attorney General of the State of Kentucky,

Appellees.

PRELIMINARY STATEMENT.

On the 28th day of April, 1920, the City of Catlettsburg, Kentucky, filed complaint with The Railroad Commission of Kentucky, alleging that the rate for natural gas furnished for domestic use was unrea-

sonable, unjust and extortionate. Subsequently the Cities of Louisa and Ashland intervened and made similar complaint. (R. 163.)

After a hearing, in which both the complainants and the United Fuel Gas Company introduced evidence, The Railroad Commission of Kentucky entered an order, dated January 18th, 1922 (R. 103); reducing the rate to 80% of the 40 cent net rate then being charged putting into effect a rate of 32 cents per M. cu. ft. The United Fuel Gas Company continued to charge a rate of 32 cents per M. cu. ft., less 1c per M. cu. ft. for prompt payment of bills, until the 11th day of July, 1923, when there was filed before The Railroad Commission a motion asking the said Commission to revoke and set aside its order of the 18th of January, 1922. (R. 379)

On the 29th day of August, 1923, the Warfield Natural Gas Company, which was organized, owned, and controlled by the United Fuel Gas Company, and to which had been conveyed all of the property belonging to the United Fuel Gas Company in Kentucky filed its petition before The Railroad Commission in which it attempted to set up a contract that had been entered into between it and the United Fuel Gas Company which contract provided that the Warfield Natural Gas Company should purchase gas from the United Fuel Gas Company at the Big Sandy River at the rate of 30 cents per M. cu. ft. and asking the Commission for permission to charge a rate of 45 cents per M. cu. ft., less a discount of 5 cents per M. cu. ft. for prompt payment of bills. (R. 379) The Cities of Ashland, Catlettsburg and Louisa resisted said petition

by appropriate pleadings (R. 399) and upon a hearing held upon the motion of the United Fuel Gas Company and the petition of the Warfield Natural Gas Company and after all of the evidence had been introduced in behalf of the complainants and protestants the Railroad Commission on December 11th, 1923, entered an order denying the motion of the United Fuel Gas Company to vacate the order of January 11th, 1922, and refused and denied the petition of the Warfield Natural Gas Company but upheld its order fixing a rate of 32 cents per M. cu. ft. but provided a discount of 4 cents per M. cu. ft. for prompt payment. (R. 387)

It also denied the petition of the Warfield Natural Gas Company to withdraw from business in the State of Kentucky. The appellants herein being dissatisfied filed their bill of complaint in the United States District Court for the Eastern District of Kentucky on the 29th day of December, 1923, in which they alleged that the rate fixed by the Railroad Commission of 32 cents at each of its hearings was confiscatory and therefore in violation of the 14th Amendment of the Constitution of the United States. (R. 1) The Judge for the Eastern District of Kentucky having refused to sit in the case, Judge Hickenlooper, of the United States District Court for the Southern District of Ohio (R. 739), sitting by designation in the Eastern District of Kentucky, granted a temporary restraining order (R. 1592) and upon a hearing held before a three Judge Court for a temporary injunction, Judge Denison, of the Circuit Court of Appeals, and District Judges Hickenlooper and Jones sitting issued an order permitting the consumers to pay either the 32 cent

rate or the 40 cent rate as they might choose (R. 1593), and impounded excess over 32 cent rate under bond for repayment.

The Railroad Commission of Kentucky answered the complaint of the companies by a general denial and also in an amended answer which was filed herein, alleged certain affirmative matter, which was never denied by the appellants and which will be dealt with later. (R. 739, 754)

Thereafter upon a final hearing before Judge Hickenlooper and upon the testimony introduced before The Railroad Commission and upon other additional evidence offered by both the Companies and the protestants the Court in an opinion and order held that the rate of 32 cents per M. cu. ft. was not only not confiscatory but a reasonable rate and upheld the order of the Commission fixing the rate at 32 cents per M. cu. ft. (R. 1595), and ordered refund in excess of 32 cents paid by consumers.

United Fuel Gas Co. v. Railroad Commission,
13 Fed. 2nd Series 510.

CONSTITUTIONALITY OF THE STATE STATUTE.

Some question is made that the Act creating The Railroad Commission is unconstitutional and in violation of Section 51 of the Kentucky Constitution, which provides that: (R. 4-5)

> "No law enacted by the General Assembly shall relate to more than one subject, and

that shall be expressed in the title, and no law shall be revised, amended or the provisions thereof extended or conferred by reference to its title only, but so much thereof as is revised, amended, extended or conferred shall be re-enacted and published at length." (R. 1567)

In answer to this proposition we quote the lower Court's answer to the objection raised by the appellants in the following language: (R. 1571)

"While the question of the constitutionality of the act of the Kentucky legislature of March 22, 1920, giving the Railroad Commission jurisdiction in the matter of fixing rates for public utility companies, presents a question of State law only, this Court having taken jurisdiction upon the Federal question involved there would seem to be no question that we may, if it is necessary or desirable, determine any questions of state law which may be presented.

Siler v. L. & N. R. R. Co., 213 U. S. 175;

L. & N. R. R. Co. v. Garrett, 231 U. S. 298;

Greene v. Louisville Interurban R. R. Co., 244 U. S. 499;

Texas Co. v. Brown, 258 U. S. 466;

Wichita R. R. & L. Co. v. Public Utilities Commission, 260 U. S. 48.

Among other provisions, Section 14 of this act defines the powers and duties of the Commission whenever a complaint is filed that rates are extortionate; Section 23 con-

fers upon the Commission the power of granting or refusing the right to withdraw from business in only a portion of the Commonwealth, while Section 3 provides for the filing of schedules of changes of rate with the Railroad Commission, and by necessary implication, authorizes such changes. All of these sections pertain directly to the jurisdiction, powers and duties of the Railroad Commission of Kentucky and refer to the subjects of such regulation only as defining the multifarious nature of the duties and powers of such Railroad Commission with reference to public utilities. The title of this Act reads:

"An act to repeal and re-enact Chapter 18 of the Acts of 1916 * * * so as to prescribe the duties and powers of the Railroad Commission with reference to * * * * * natural gas companies, and natural gas transportation companies * * * * * " This title would seem to be comprehensive and to clearly include the matters mentioned, notwithstanding each element of jurisdiction or duty imposed is not separately mentioned. *Eastern Kentucky Coal Lands Corporation v. Commonwealth*, 127 Ky. Rep. 667 (106 S. W. 260) (108 S. W. 1138). The Act was also apparently recognized as a valid and subsisting enactment in the case of *Illinois Central R. C. v. Railroad Commission of Kentucky*, 1 Fed. (2nd) 805, which was a three judge case heard before Circuit Judge Denison and District Judge Cochran and Sater. Some question might also be raised as to an estoppel against the present complainants to now raise this question after having voluntarily invoked the jurisdiction of the Commission and being thereafter dissatisfied with the ruling of such commission.

"Aside from these questions and from our present inclination to hold that the Act refers to but one subject, the jurisdiction of the Railroad Commission, and that such subject is sufficiently expressed in the title, it does not seem essential that we now determine this question. The companies, by the allegations of their petition, invoke the jurisdiction of this Court solely upon the ground that the rates fixed deprive them of their property without due process of law. The companies are admittedly public utility corporations, and as such are subject to the usual obligations of such utilities which may be tersely stated as the duty to serve all who apply, without discrimination and at 'a reasonable rate.' In order to invoke the jurisdiction of this Court as a court of equity, the complainant must have suffered injury as to a property right, as to which injury he is without adequate remedy at law. In order to state a cause coming within the Fourteenth Amendment it is not only necessary that the procedure provided by state enactment shall lack due process of law, but the complainant must have been deprived of his property by reason thereof. We do not understand the language of the Court in the case of *Illinois Central R. Co. v. Railroad Commission of Kentucky* supra, 'since the statute does not provide for any judicial review, an order made by the Commission without any substantial—evidence upon which to base it is arbitrary, is not due process of law, and calls upon any court of competent jurisdiction to enjoin its execution,' to mean more than that the Commission must act upon evidence and not arbitrarily, that the Commission is the forum in

which evidence must first be introduced, and that any case, decided by a commission under a law in which no provision is made for judicial review, has reached the justiciable stage for raising the constitutional question under the Fourteenth Amendment immediately upon the issuance of the Commission's order. If the rates fixed are such as to allow a reasonable return upon the fair value of the property, used and useful in the business, the company is compelled only to comply with its common law obligations. If the return is adequate within common law principles, there would seem to be no irreparable injury to the property rights of the company and no deprivation of property of the company without due process of law. Where the rates are reasonable, therefore, and the company is required only to perform its common law obligation, the court would seem to be without general equity jurisdiction to enjoin, and there would seem further to be no violation of the Federal Constitution certainly the mere fact that a state statute is claimed to violate the state constitution is not ground for invoking the jurisdiction of the Federal District Court, except pending a determination of the question of confiscation. The suit should proceed for the purpose of determining whether the maximum rates fixed by the Commission are confiscatory, but, if found to be not confiscatory, a permanent injunction should nevertheless issue to restrain the enforcement of penalties accrued *pendente lite*. *Oklahoma Operating Co. v. Love*, 252 U. S. 331-337-8. If the rates are determined to be confiscatory, a permanent injunction would of course issue as to their enforcement."

The leading and most important case decided by the Court of Appeals of the State of Kentucky relating to this same question is the case of *Eastern Kentucky Coal Land Corporation v. Commonwealth*, reported in 127 Ky. Reports 667, 106 S. W. 260. At page 702 of said opinion, as reported in the Kentucky Reports, the Court said:

> "It is contended that the act violates Section 51 of the constitution, which requires that every legislative act shall relate to but one subject, which shall be expressed in its title. The title to the act is: 'An act relating to revenue and taxation.' If this article is bad for the reason last assigned, then much, if not most of the existing revenue law of the state must fall for the same reason. A great many instances might be cited from that act, but we will confine ourselves to a few. Railroads and other public service corporations are required to report certain information upon which their assessments are to be based by the State Board of Valuation and Assessment. Their failure is penalized by a fine of from fifty to a thousand dollars, and the suspension of the corporate franchise" • •
>
> "All these matters are germane to the title, Revenue and Taxation, which is the subject of the act."

The title of the act under consideration expressly provides that it relates to the duties and powers of the Railroad Commission, limited as to express companies, steamboats, steamboat companies, telegraph companies, telephone companies, natural gas companies and natural gas transportation companies, and the provisions of said act are limited to the duties and

powers of said Railroad Commission in respect to the different companies therein named. Many other cases could be cited, as set forth under Section 51 of the Constitution of the State of Kentucky, Carroll's Kentucky Statutes, 1922 Edition, supporting our contention, a few of which follow:

Commonwealth v. Barney, 115 Ky. 475; 74 S. W. 181;

Joyce v. Woods, 78 Ky. 386;

Williams v. Wedding, Judge, 165 Ky. 361; 176 S. W. 1176;

Mulligan v. McGregor, 165 Ky. 222; 176 S. W. 1129;

Larne v. Redman, 168 Ky. 487; 182 S. W. 622;

Town of London v. Brown, 183 Ky. 63; 208 S. W. 317.

Also this Court affirmed the Kentucky Court of Appeals in the Case of *Eastern Kentucky Coal Lands Corporation v. Commonwealth of Kentucky* above cited, in 219 U. S. 137.

THE RIGHT TO WITHDRAW

The United Fuel Gas Company furnished gas to the Cities of Catlettsburg, Ashland and Louisa, under franchises which expired on the 21st day of January, 1918, the 3rd day of January, 1918, and on the 1st day of July, 1918, respectively. After the expiration of these franchises the United Fuel Gas Company continued to supply gas to each of said three Cities as well as to industrial consumers and other communities in Kentucky.

In 1920 the General Assembly of the Commonwealth of Kentucky passed an Act known as Chapter 61, of the Acts of the General Assembly of 1920. (R. pp. 22 et seq., Acts of 1920, Ky. 250.)

Among other things, Section 23 of said Act provides:

> "If the franchise of any public service company embraced in this act shall have expired, and the service is continued without obtaining a new franchise, the said public service company shall be subject to the jurisdiction and authority of the Railroad Commission, and shall not withdraw its service from any municipality, county or community without first obtaining the permission of the said Railroad Commission so long as it remains in business in this Commonwealth, or any part thereof."

Other provisions of the statute purport to grant to the Railroad Commission power and authority to investigate upon complaint, whether any company engaged in the distribution, furnishing or sale of natural gas is collecting or receiving extortionate rates, and also the power to fix a just and reasonable rate.

Under this Act the Cities filed complaint with the Railroad Commission (R. pp. 163, 77, 83) and the Commission on the 18th of January, 1922, held that the rates then being charged were unreasonable and extortionate and directed the Company to put into effect a rate finally determined to be 32 cents per M. cubic feet.

The United Fuel Gas Company continued to serve all of these Cities as well as industrial consumers and other communities in Kentucky.

In June, 1923, the United Fuel Gas Company conveyed all of its property to the Warfield Natural Gas Company for the reasons stated by its General Manager, Mr. H. A. Wallace, "no doubt it was to put ourselves in a better technical position." (R. 779)

On the 28th day of June, 1923, the Warfield Natural Gas Company filed with the Railroad Commission of Kentucky a schedule and thereafter on the 29th day of August, 1923, the Warfield Natural Gas Company filed its petition with the Commission asking that certain rates requested in said schedule should be put into effect. And also in this petition it virtually said to the Commission unless you fix this rate we ask permission to withdraw from business in the Cities.

Bearing in mind that the United Fuel Gas Company and the Warfield Natural Gas Company continued to serve in the Cities from the expiration dates of their franchises until now, it seems that that part of the Court's opinion in the Case of *Union Heat, Light & Power Co. v. Ft. Thomas, et al.*, should apply (215 Ky. 384; 285 S. W. 228):

> "Appellee city relies upon subsection 23 of Section 201e, Kentucky Statutes as authorizing the relief prayed because, as it says, the gas service was continued without obtaining a new franchise. True, the service was continued, but it was under mandatory orders of the court and over the protest and against the objection of the gas company."

"Had the gas company voluntarily continued to furnish gas to the city and other consumers after the expiration of the franchise, it would have brought itself within the provisions of this subsection and become subject to the jurisdiction of the Railroad Commission if the act should be finally held constitutional. But it did not do so, but only supplied gas in pursuance to the mandatory direction of the Court, and therefore did not come within the provisions of this section."

In the above Case the Court of Appeals of Kentucky simply held that as the franchise contract itself provided by its express terms that the Gas Company could withdraw, the Gas Company could rely upon this contract provision of the franchise and the court so said as follows:

"It is not deemed necessary to go into a discussion of the constitutional questions presented, since we have arrived at the conclusion that the franchise contract, and especially section 12 thereof, permitting appellant gas company, upon giving the 30 days notice specified, to withdraw its service from appellee city in all cases where such gas service was not voluntarily contracted by the company, makes it unnecessary, for the purpose of this case, to do so."

However, it was expressly held in this Case that if the Gas Company continued to distribute and sell gas within a city without franchise or continued in a city after expiration of a franchise it must do so under reasonable rates, terms and conditions and courts of equity may be applied to in order to prevent imposition of excessive rates, or unreasonable and unjust rules.

"Of course if a gas company enters a city without a franchise and begins to distribute and sell gas or continues in the city after its franchise has expired and distributes and sells gas, its rates, terms and conditions must be reasonable and courts of equity may be applied to, to prevent the imposition of excessive rates or unreasonable and unjust rules *and under certain conditions the continuance of the service.*" (Italics ours.)

These same parties were involved in litigation concerning the same matters before a three judge court consisting of Circuit Judge Moorman, and Hicks and Dawson, District Judges (17 Fed. 2d. 143), that Court approved the ruling in the Case before the Court of Appeals of Kentucky, and further said after setting forth Subsection 23, of the Kentucky Statute:

"If this section is in harmony with the Constitution of Kentucky, which question we do not feel called upon to decide, it, at most, gives the Railroad Commission the right to force a continuation of service only in those cases where the public service corporation has continued in the business which it conducted under its franchise after the expiration of that franchise."

In both of the above decisions the ruling of Judge Hickenlooper in this case is not condemned but by inference above noted is expressly upheld.

Judge Hickenlooper in the present Case said (R. 1572):

"Some question might also be raised as to an estoppel against the present complain-

ants to now raise this question, after having voluntarily invoked the jurisdiction of the Commission, and being thereafter dissatisfied with the ruling of such Commission."

which clearly applies on this question of withdrawal.

He further expressly held on this question (R. pp. 1587-1588.):

"One of the recognized duties of the public utility being to serve all who apply, such companies are not only subject to legislative regulation in this respect. N. & W. R. Co. v. Public Service Commission of West Virginia, 265 U. S. 70, 74, 44, S. Ct. 439, 68 L. Ed. 904. But this common law duty can be enforced by a court of equity. Having assumed jurisdiction in the instant case, the court will retain jurisdiction to insure the doing of complete justice as between both parties. It is, perhaps, not disputed that, if the company wished to withdraw from business in the entire state, it would be justified in so doing. This, after a fashion, the United Fuel Gas Company, has attempted to do, but in creating the Warfield Natural Gas Company, of which it owns the entire capital stock, it has but created an instrumentality for the continuance of its business, and neither company contemplates the abandonment in Kentucky.

"A court of equity will look through the mere fiction of corporate entity to the fact that the United Fuel Gas Company is now, as heretofore, doing business in the state, and is enjoying the privileges of a public utility in Kentucky, among which is the right of eminent domain, and the right to occupy, cross,

and use the public highways in various portions of the Commonwealth. The mere fact that the franchises in the various cities have expired does not make the continuance of this business illegal, for, under Section 23 of the Railroad Commission Act, the enterprise is now to be considered a state venture and not a municipal one. The state is the unit, and not the municipality. There is no obligation to continue in the state, but if they do continue in the state, they are subject to their common law, and statutory duties in all parts of the state, county, township and municipal. This would not only seem to be the result of recent legislation, but also to be the trend of judicial view in Kentucky and elsewhere. See Southern Railway Company in Kentucky v. Hatchett, 174 Ky. 463, 192 S. W. 694, L. R. A. 1917 D, 1105; North Carolina Public Service Co. et al. v. Southern Power Co. (C. C. A.) 282 F. 837, 844, 32 A. L. R. 626; Missouri Pacific Ry. Co. v. Kansas, 216 U. S. 262, 277, 30 S. Ct. 330, 54 L. Ed. 472; and Pennsylvania v. West Virginia, 262 U. S. 553, 43 S. Ct. 658, 67 L. Ed. 1117, 32 A. L. R. 300; also N. Y. ex. rel. Gas Co. v. McCall, 245 U. S. 345, 38 S. Ct. 122, 62 L. Ed. 337.

"The cases cited to the contrary are those in which the company, by withdrawing from the municipality, likewise withdrew from the entire state. The mere fact that the public service duty requires perhaps the expenditure of capital for supplying suitable facilities reasonably necessary for the performance of the obligation does not constitute taking of property without due process of law. See N. & W. Ry. Co. v. Public Service Commission, supra.

"To hold otherwise than above might be compared to the case of unsatisfactory rate for carriage by railway of any specific commodity, say, coal and the announcement by the railway that it would withdraw from the business of receiving coal for transportation, and would haul no coal at the rate fixed, nor at any rate, until the rate proposed by it was authorized. Clearly a utility cannot abandon part of its business, because the rate is not satisfactory, while operating as to the remainder."

Our position is:

FIRST: That Subsection 23 of the Act is constitutional and applies here because the Gas Company voluntarily, after the expiration of the franchises, for a long period of years served the Cities involved in this litigation.

SECOND: That the Gas Companies cannot attempt to invoke the aid of the Railroad Commission in giving them certain rates and at the same time deny the jurisdiction of the Railroad Commission upon the question of withdrawal.

Then it is our earnest contention that they subjected themselves to the jurisdiction of the Railroad Commission when they were there for the purpose of securing a reasonable rate and if the rate is reasonable they can have no complaint.

ESTOPPEL OR WAIVER

The United Fuel Gas Company, plaintiff, herein on the first hearing before the Railroad Commission,

submitted itself to the jurisdiction of the Railroad Commission of Kentucky without raising either the question that the title of the act was insufficient under Section 51 of the Kentucky Constitution or that Subsection 23 of the Act of 1920 was void or in contravention to Sections 163 and 164 of the Kentucky Constitution. (Record 43 to 107 inclusive.)

It will first be noticed that the Warfield Natural Gas Company is a Kentucky Corporation and was organized under the laws of the State of Kentucky, which granted its charter on the 18th day of February, 1922, and after the effective date of Chapter 61 of the Acts of General Assembly of 1920.

Thereafter, on the second hearing before the Railroad Commission of Kentucky which was begun by a petition filed by the United Fuel Gas Company before said Commission on the 11th day of June, 1923, and by the Warfield Natural Gas Company on the 29th day of August, 1923 (said Proceedings are shown on pages 369 to 381 of the record), they sought either to file an increase in rates to be charged for natural gas in the several cities under the act which they are now questioning or, as the Warfield Natural Gas Company plead

> "In the alternative, your petitioner further prays that this, its petition, may be regarded as an application by it under Section 23, Chapter 61, of the Acts of the General Assembly of Kentucky for the year 1920, for permission to petitioner from this Commission to withdraw its service from each of said three defendant municipalities, for

the reason hereinbefore set forth and for other reasons which may be assigned at the hearing of such application; that after notice to each of said defendant cities and an opportunity to be heard, the Commission will enter an order, under the provision of said last mentioned statute, granting leave to this petitioner to withdraw from service."

This Court, in many cases, as well as other Federal and State Courts, have repeatedly held that under such circumstances as obtained in this case the plaintiffs have no right to claim that the statute, under which they were claiming certain rights, is unconstitutional and they are estopped in any subsequent proceedings to question its invalidity.

This Court said:

In Booth Fisheries Company v. Industrial Commission, 271 U. S., 208.

"More than this, the employer in this case having elected to accept the provisions of the law, and such benefits and immunities as it gives, may not escape its burden by asserting that it is unconstitutional."

The rule is tersely stated:

In Kansas City, M. & B. R. Company v. James P. Stiles, 242 U. S., 117.

"The railroads comprising this consolidation entered upon it with the Alabama statute before them and under its conditions, and, subject to constitutional objections as to its enforcement, they cannot

be heard to complain of the terms under which they voluntarily invoked and received the grant of corporate existence from the State of Alabama."

Also in J. W. Hurley v. Commission of Fisheries of Virginia et al., 257 U. S., 225 and 226.

"A majority of the three judges composing the court below concluded (264 Fed. 116) that the Commission had acted in substantial compliance with the challenged statute, that whatever rights of property appellant claimed in respect of the specified lands, or the oysters thereon, were necessarily based upon the statute itself, and that he could not both assail it and rely upon it in the same proceeding (Kansas City, M. & B. R. Co. v. Stiles, 242 U. S. 111, 117, 61 L. Ed. 176, 186, 37 Sup. Ct. Rep. 58)."

To the same effect—St. Louis Malleable Casting Company v. George C. Pendergast Construction Company, 260 U. S., 353, 470, 471, 472, and 473.

Pullman Company v. Friend W. Richardson, 261 U. S., 330.

It is said:

In Buck v. Kuykendall, 267 U. S. 316.

"It is true that one cannot, in the same proceeding, both assail a statute and rely upon it."

In the Case of *Pennsylvania v. West Virginia*, 262 U. S. 1117, this Court held:

"The attitude of the complainant states is not that of mere volunteers attempting to

vindicate the freedom of inter-state commerce or to redress purely private grievances. Each sues to protect a two fold interest—one as the proprietor of various public institutions and schools whose supply of gas will be largely curtailed or cut off by the threatened interference with the inter-state current, and the other as the representative of the consuming public whose supply will be similarly affected. Both interests are substantial and both are threatened with serious injury.

"Each state uses large amounts of the gas in her several institutions and schools—the greater part in the discharge of duties which are relatively imperative. A break or cessation in the supply will embarrass her greatly in the discharge of those duties and expose thousands of dependents and school children to serious discomfort, if not more. To substitute another form of fuel will involve very large public expenditures.

"The private consumers in each state not only include most of the inhabitants of many urban communities, but constitute a substantial portion of the state's population. Their health, comfort, and welfare are seriously jeopardized by the threatened withdrawal of the gas from the interstate stream. This is a matter of grave public concern, in which the state as the representative of the public, has an interest apart from that of the individuals affected. It is not merely a remote or ethical interest, but one which is immediate and recognized by law."

Even under the common law, which is recognized by the Court of Appeals of Kentucky in the Case cited,

the appellants were under the duty to furnish gas to these Cities without discrimination because they were already furnishing other communities and industrial consumers in northern Kentucky providing that the rate were reasonable.

It might be added that in Kentucky these gas companies exercise the right of eminent domain.

Calor Oil & Gas Company v. Franzell, 128 Ky. 715.

From the time of the expiration of these franchises in the various cities in 1918 until the middle of the year of 1923, the inhabitants of all these different cities and communities effected in this case expended millions of dollars for appliances, stoves, and other gas fixtures and piping in thier homes and places of business. This expenditure upon the part of the public was made at least partly on account of the fact that the Gas Company had never objected to the continued furnishing of gas. A large part of the homes and business places in these communities effected have so constructed their houses and the appliances therein to the use of gas that to withdraw the supply would result not only in hardship to the individuals, schools, churches and other public institutions but would render the appliances so bought and the piping so installed useless and would entail a large property loss to thousands of individuals and public institutions.

No one is questioning the right of the Gas Company to continue serving. No city or tax payer is raising any question as to its right to continue the service. It has ample authority to prevent the destruction of its

property if the Cities demanded its withdrawal by requesting a franchise and it is certainly hard to understand the appellants position and its position before the Railroad Commission and before the lower Courts when upon one hand it says, we will continue to serve if the net rate is fixed at 40 cents but if you will not fix the net rate at 40 cents we desire to withdraw. It seems as if this inconsistent position should not be tolerated by a court of equity.

The dependence of municipalities and their citizens in the complexities of modern life on the great public utility companies which furnish them with the daily necessities of life such as light and heat cannot be exaggerated. Frequently these companies are monopolistic by reason of the fact that they absolutely control the source of supply, the mains, pipes, conduits and appliances for delivery. In the case at bar the United Fuel Gas Company and the Warfield Natural Gas Company, its subsidiary, not only furnish and has been furnishing gas to the Cities of Ashland, Catlettsburg, Louisa, Russell and Greenup and all of their citizens and inhabitants, but in like manner many other cities and municipalities in North Eastern Kentucky, and is now furnishing all the gas used for municipal, manufacturing and domestic purposes by the inhabitants of North Eastern Kentucky.

So it will be readily seen that unless the decision of the lower Court is upheld that the gas companies will notify these cities and communities in North Eastern Kentucky, that unless you pay us the rate that we demand we will withdraw the service of furnishing gas. In other words they will immediately practice

extortion, unless the people in these communities have the Spartan courage to do without gas as a fuel.

This question of withdrawal has been before the courts in several cases affecting certain other cities in the State of Kentucky. In the Case of the *City of Moorhead v. Union Light, Heat & Power Company*, 255 Fed. Rep. 920, 923, the Court said:

> "It is finally urged that the franchises are not mandatory but permissive, and that the company has a right at any time to withdraw from performance when performance will entail an actual loss. There are numerous decisions which have held that street railway companies may withdraw their service from a limited section under the circumstances named. My attention has not been called to any case authorizing a public utility company to withdraw from supplying an entire city with a commodity like gas or electricity. I shall not attempt to determine at this time whether defendant possesses such a right. If any such right exists, it would need to be carefully safeguarded. The public has rights in such a case as well as the company. It should not be withdrawn except upon a clear notice of intention to withdraw given for such a time as under the circumstances of the case will enable the municipality to contract with another private company to supply the commodity, or enable the municipality to erect a plant and furnish the article for itself and its inhabitants. After a community has become accustomed to the use of gas or electricity, it cannot be suddenly thrown back and commanded to use oil lamps and coal

ranges. It is entitled to sufficient notice to enable it, in the exercise of reasonable diligence, to secure the service from which the utility company has withdrawn."

In 28 C. J. 557, it is stated as a general proposition:

"A summary and unconditional discontinuance of service however should not be permitted without reasonable notice, in order to afford customers an opportunity to obtain service from another source, and adjustment to the new situation, and the repayment of deposits may and should be required."

In the case of *City of Louisville, et al., v. Louisville Home Telephone Co.* (C. C. A.), 279 Fed. 949, that contention was also made and answered. In that case it was held:

"Though a city, unless restrained by statute, can eject a utility corporation from the streets after the expiration of its franchise, it must allow compensatory rates, so long as it requires the corporation to continue to give public service.

"Const. Ky., Section 163, providing that no public service company shall use city streets without the consent of the council, prevents the legislature from compelling the council to permit a new or additional use of the city streets, but does not prevent it from prohibiting the council from practically destroying the value of property dedicated to public use after it has consented to the occupation of the streets for such purpose, so that

Ky. St. Sec. 3037d, requiring the council to offer a new franchise for sale before the expiration of the old franchise is valid."

In that case the Court said:

"The company has carried on its business in Louisville for 20 years under a franchise which fixed the rates and the term of which expired March 7, 1921. The city council on May 26, 1921, passed a rate ordinance which by its terms was to continue for one year only, within which period it was assumed that some permanent disposition might be made. It is the rates fixed by this temporary ordinance which were said to be confiscatory. It is now the settled rule, where a rate fixing service franchise has expired, and where there is not inconsistent statute, that the city has an optional right to eject the corporation from the streets, but that, so long as the city requires the corporation to continue to give public service it must allow compensatory rates. The Denver Case, 246 U. S. 178, 38 Supt. Ct. 278, 62 E. Ed. 649; the Detroit Case, 248 U. S. 429, 39 Sup. Ct. 151, 6E. L. Ed. 341; the Toledo Case (C. C. A. 6), 259 Fed. 450, 453, 170 C. C. A. 426.

"In attacking the position of advantage thus claimed by the Company, the city first says that Section 3037d is unconstitutional and invalid, because Section 163 of the Constitution provides, in effect, that no public service company shall use the streets without the consent of the council, and it is therefore argued that no legislative act can compel the consent of the council to the extent in-

herent in the carrying out of Section 3037d. Specifically it is said, that if, when the Home Company franchise expired, the council was satisfied with the service being given by a competing company, it had the constitutional right, under Section 163, to refuse consent to the longer occupation of the streets by more than one company.

"It may be conceded, for the argument, that the legislature would have no power to compel the council to permit a new and additional use of the streets, and to do so by requiring a new and second franchise to be sold when there was one in existence and satisfactory operation. Such concession does not reach the case. To compel the city to permit burdening the streets with a new easement is one thing, but it is quite another thing merely to require that the council, when it has once consented to such burden, shall be reasonable and not arbitrary, in its treatment of the property which has been dedicated to public use under that consent, and shall not insist that such property be practically destroyed while it still desires public service of that character, and while the company continues willing to render it upon reasonable conditions. *We do not doubt that the protection of invested property, to that extent, continued to be within the reasonable discretion of the legislature, without impairment by Section* 163." (Italics ours.)

It will be seen that the rights and duties herein are reciprocal and the city would have no right to order the destruction of appellant's appliances and equipment in

the city street so long as it desired a public service of the character furnished by appellant.

From what is last stated in the above opinion, and which is now the law in the State of Kentucky a company whose franchise has expired can compel a council or other legislative body of any municipality to sell a franchise "which shall be reasonable and not arbitrary."

It is our view of this case that if a legislature of the State of Kentucky has the power to pass Subsection 3037D of the Kentucky Statutes requiring a council or other legislative body to sell a franchise or in other words if the legislature of Kentucky has the power to add to or modify sections 163 and 164 of the State Constitution for the protection of a public utility then surely the legislature should have the power to pass Subsection 23 of the Railroad Commission Act for the purpose of protecting the people.

It is generally recognized that the business of public service corporations is clothed with a public interest and such corporations stand in different and peculiar relationship to the public and have different duties and obligations to perform than other corporations.

In *Owensboro Gas Light Company v. Hildebrand*, 19 Ky. L. R. 983, 42 S. W. 251, it was held:

> "Gas and electric light companies, which are given the use of the streets of a city for their pipes, and wires, and the right to acquire the use of lands for their business by writs of ad quod damnum, being quasi pub-

lic corporations, must furnish the city's inhabitants with light upon conditions common to all."

In *Commonwealth v. Louisville & Nashville Railroad Company*, 120 Ky. 104, the court said:

> "Railroads are creatures of the law, invested with certain powers to promote the public interest, for which reason they may be required to conduct their affairs in furtherance of the public objects of their creation; and it is because of this public character that courts assume jurisdiction to enforce the public duties required of them."

In *North Carolina Public Service Company v. Southern Power Company*, 282 Fed. 837, the court said:

> "The Southern Power Company has conferred great benefits on the public in developing water power which before was running to waste. For their enterprise and ability those who have invested in it and successfully managed it, are entitled to liberal compensation. Yet development of this great natural resource connotes the possibility of power of accumulation and destruction, which no free people can allow to go unchecked in any direction or in any form of application. The people of North Carolina have explicitly provided for control and regulation of this power in very comprehensive terms, and it is not for the courts to defeat or emasculate that control and regulation by holding that it does not apply to one of the chief corporate activities of the power company. The corporation asked and received of the public the right of

eminent domain, and the right to sell its current to independent vendors, which in turn furnished many towns and cities and thousands of homes and places of business in the state. It has used these rights and is still using them. That the public has a most vital interest in their exercise seems plain beyond discussion. To state the claim now made—that the corporation can continue to exercise these powers bestowed by the public, without responsibility to the public, arbitrarily discriminating in rates—is to reject it."

In *Wolff Packing Co. v. Court of Industrial Relations*, 262 U. S. 523, the court said at page 535:

"Business said to be clothed with a public interest justifying some public regulation may be divided into three classes.

(1) Those which are carried on under the authority of a public grant of privileges which either expressly or impliedly imposes the affirmative duty of rendering a public service demanded by any member of the public. Such are the railroads, other common carriers and public utilities."

EVIDENCE BEFORE THE RAILROAD COMMISSION.

The evidence before the Railroad Commission was substantially the same for protestants as the other evidence introduced for them in this case and it may be found in the Record, Page 41 to 735, inclusive.

Judge Hickenlooper said concerning the evidence before the Railroad Commission:

"Both hearings before the commission were upon elaborate evidence and the anal-

ysis and testimony of experts. The entire records of both hearings were, by stipulation of counsel, offered as evidence in the hearing of the application for interlocutory injunction, and have since been supplemented by additional evidence upon questions of valuation and earnings. The books of the companies have been accurately kept to the minutest detail, and afforded a wholly reliable source of information as to all matters here involved. This evidence is complete for the year ending December 31, 1923, although not entirely satisfactory as to the fiscal year ending December 31, 1924. We shall accordingly treat generally only with the evidence of values and operations for the year 1923."

In the plaintiff's bill of complaint (R. 10 and 12) they allege that the fair value of the entire property was $60,000,000, and that allocated to Kentucky was $5,0000,000, or 8⅓% of the entire property.

It might be noted that W. H. Weiss (R. 199 et. seq., 295 et seq., 493 et seq., 722 et seq.) the engineer for the protestants in the hearing before the Railroad Commission arrived at substantially the same conclusion as Mr. Jirgal and Mr. Hagenah in their testimony before the Court.

There was no evidence before the Railroad Commission of Kentucky fixing the value of the leaseholds upon any other basis except exchange value.

There has also been cited by the appellants the Case of *Illinois Central Railroad Co. v. Railroad Commission*, 1 Fed. 2nd 305, to sustain the proposition that as there was no special finding by the Railroad Com-

mission that their opinion and order was without due process of law. Suffice to say that in the Case cited the lower Court decided it upon its merits. In other words, they decided that there was not sufficient evidence to justify a reduction of the rates. The Court simply held that he evidence before the Railroad Commission did not justify a reduction in rates in that case.

In this case there is not only the voluminous record before the Railroad Commission which sustains every proposition decided by the lower Court in this case but the Court of its own accord permitted supplemental and additional testimony by both the Company and the protestants, and upon the question of confiscaion all the evidence heard in this case either before the Railroad Commission or the lower Court must be considered.

DECISION OF THE DISTRICT COURT IN THIS SUIT

The plaintiff filed its bill in the District Court of the United States for the Eastern District of Kentucky, in which it sought an injunction to restrain the enforcement of the orders of the Railroad Commission of Kentucky denying plaintiff an increase in rates, and fixing the rate of thirty-two cents (32c) per M. Cu. Ft. The District Court granted a temporary restraining order, and upon the application for an interlocutory injunction pursuant to Section 266 of the judicial code which was heard before Circuit Judge Denison and District Judges Hickenlooper and Jones, the Court did not disturb the orders of the Railroad Commission but permitted the

consumers to pay either the rate fixed by the Railroad Commission or pay the rate named by the complainants. Upon final hearing of this case for a permanent injunction the Court denied the application, except as to certain penalties which arose *pendente lite*:

"United Fuel Gas Co. v. Railroad Commission, 13 Fed. 2nd Series 610."

Judge Hickenlooper in his opinion upon the final submission of the case found on page 1580 of the Record that the value of the property upon which plaintiff was entitled to a return was $37,015,564.00 made up of the following elements:

Natural Gas leases, book value	$ 6,732,920.00
Production, physical plant	7,830,400.00
Transmission	11,154,326.00
Distribution	2,694,806.00
General property	594,742.00
Total	$29,007,194.00
Overhead, 18% upon depreciable physical plant	4,009,370.00
Working capital	999,000.00
Going concern value	3,000,000.00
	$37,015,564.00

On the matter of net earnings available for the depletion and depreciation and return the Court made the following findings:

"By way of illustration, the court, at the time of the hearing of the application for interlocutory injunction, applied the method of computing return which was a-

dopted by the complainant's Hightower (Exhibit No. 10, second Commission hearing), to a rate base of $36,000,000. The period covered was for the year ending June 30, 1923, during which the company was charged 31 cents net per thousand cubic feet of gas, or gross rate of 32 cents less 1 cent discount. The result of this application as to Ashland and Catlettsburg combined was as follows:

Investment.	
Production, peak	$2,238,269.00
Transmission, peak	428,326.00
General, peak	9,251.00
Distribution, actual	242,640.00
Incomplete construction, peak	35,574.00
Total investment allocated	$2,954,060.00
Operating revenue	918,723.00
Operating expense allocated	284,769.00
Gross earnings	633,953.00
Return before depletion and depreciation	21%

"Reference might also be made to Jirgal's Exhibit No. 2 for the year ending December 31, 1923. If the rate base be increased from that used by Mr. Jirgal to the $37,000,000 here adopted, and depletion and depreciation be fixed at 5%, we have for the territory there covered:

Investment	$3,275,850.00
Earnings	749,839.00
Depreciation and depletion	163,792.00
Net earnings	586,047.00

or a net return of 17.7% after allowance of depletion and depreciation of 5%.

"If the rate be figured on the basis of Wyer Exhibit 'Wyer A' (fol. 1991) (interlocutory injunction hearing), allowing 16% return on the rate base of $36,000,000, plus, we would arrive at the following:

16% return on production, calculated at 72.5% of base	$4,176,000.00
Return on transportation, 21.5% base	1,334,400.00
Return on distribution, 6% of base	345,600.00
16% return upon entire investment	5,856,000.00

"If the 1922 operating figures be applied, and production cost distributed over 45,000,000 M. cubic feet, the production expense and return combined would equal 13½ cents per thousand feet of gas. If transportation cost be distributed over 44,000,000 M. cubic feet, it would equal 3½ cents per thousand. Distribution cost distributed among domestic consumers only, or over 6,000,000 M. cubic feet, would equal 11 cents. The summary of cost of production, delivered, including a 16% return, would be as follows:

Production cost	13½ cents
Transportation cost	3½ cents
Distribution cost	11 cents
Total	28 cents

"This computation includes 16% return, and does not include gasoline earnings. There is an addition margin of profit of a minimum of four cents per thousand cubic feet over the return of 16%.

"If time permitted the illustrations could be indefinitely multiplied of recalcu-

lating the cost of gas or the percentage of net return upon a rate base of $37,000,000, in accordance with the methods pursued by the various auditors. Suffice it to say that the evidence introduced not only does not show confiscation, if the rate base be fixed at $37,000,000, but in our opinion affirmatively shows that upon such rate base the earning is at least 16% upon the property properly allocated to the municipalities here protestants." (Record 1585-6-7.)

In arriving at the net earnings above set out the court did not take into consideration any adjustments for the use of gas and gas facilities in the manufacture of gasoline, as well as the adjustment for the sale of gas to the parent companies. In another part of the court's opinion it did approve the adjustment for gasoline earnings to the extent that there should be credited to the annual gas business one-half the net earnings derived from the gasoline extraction privilege, or there should be allowed two cents per M. thousand feet of gas so treated to the credit of the natural gas business. (R. 1581-1582.)

The District Court did not pass upon the question whether the delay rentals amounting to $41,066.00 as allocated to the Kentucky business and being 6.97% of $589,186.00 (R. 1436) were properly deducted from earnings as an operating expense.

The same issue of confiscation and substantially the questions involved in this suit were raised in the bill filed by the plaintiff (United Fuel Gas Co. v. The Public Service Commission of West Virginia, 14 Fed. 209). The opinion of that court was rendered by Judge

Rose. Judge Rose fixed the rate base upon which the company was entitled to earn a reasonable return at $40,307,311.39, made up as follows:

Physical property	$26,000,000.00
Working Capital	990,000.00
Going Concern Value	3,000,000.00
Leaseholds	10,317,311.39
Total	$40,307,311.39

THE QUESTION INVOLVED

Disposing of the above minor questions we now come to the main question involved in the Case, whether the orders of the Commission fixing a rate of 32 cents per M. cu. ft. is confiscatory (R. 387) and whether the Court in declaring a rate of 32 cents per M. cu. ft. not confiscatory is correct. (R. 1595) In order to present our views of the main issue of this case, that is whether there is confiscation as briefly and concisely as possible we will at once attempt to demonstrate that there is no confiscation.

If the net earnings capitalized on a basis of a reasonable and undisputed allowance for depletion, depreciation and return will give an effective value higher than the Company can claim from the Record then there can be no question of confiscation.

The appellants claim in their bill of complaint that the present fair value of their property in Kentucky, is Five Million ($5,000,000.00) Dollars. (R. 10)

For the purposes of the present argument and without conceding the fact we will use the value of

Five Million ($5,000,000.00) Dollars, being the amount that the Company claims for Kentucky.

The total gross earnings for the Kentucky property, about which there is no dispute, is $997,589.00 for the year 1923. (R. 1420) The entire operating expenses including the ordinary taxes amounts to $294,820.00, deducting therefrom 50% of the gasoline net revenue allocated to Kentucky, amounting to $65,166.00 leaves a total for net operating expenses of $229,654.00 and leaves a gross income of $767,935.00 from which the income taxes, estimated, $18,096 should be deducted leaving $749,839.00 as net earnings available for depletion, depreciation, and return in Kentucky. (R. 1421) The only item above about which there is any question is a proper allotment for gasoline extraction that should be credited against operating expenses or added to the earnings.

THERE CAN BE NO CONFISCATION IF THE PROPER ALLOCATION IS MADE TO THE KENTUCKY PROPERTY

We cannot conceive of how applicant can claim on any reasonable basis that there has been confiscation of its property in the State of Kentucky. Except for the gasoline question, which will be hereinafter discussed, the undisputed net earnings available for depreciation and depletion (used in the sense of amortization) applicable to Kentucky business, is shown by witness Jirgal (R. 1424) to be $749,839.

The testimony supports a return of 8½ and no more. As a matter of fact, a rate of less than 8% has

in a number of cases been held by this court to be non-confiscatory. While a reasonable rate of 8% for this property might be held to be necessary in order to encourage capital to flow into the property, yet, there would be no taking of such property without due process, if a return were allowed which would permit the applicant merely to keep in operation the existing plant without regard to further expansion. In other words, confiscation implies a taking of the existing property and has no regard to future expansion. A part of the reasonable return allowed by Commissions is for the encouragement of capital to flow into the industry in the future and to deny to the applicant this part of the reasonable return does not amount to confiscation.

The Commissions and Courts have repeatedly held in natural gas cases that a return of 8% was reasonable.

Columbus Gas Company v. Columbus, 17 Fed. (2nd) 630 P. U. R. 1927 C 639;

Re: *Jackson County Light, Heat and Power Co.* (Mo.) P. U. R. 1926 D 737;

Re: *Crystal City Gas Company* (N. Y.) P. S. C. P. U. R. 1925 E 491;

Antioch v. Bayles (Ohio P. V. C.), P. U. R. 1925 E 152.

Re: Peoples Natural Gas Company (P. S. C. N. Y.), P. U. R. 1916 A 349 ..... 8%

Amhurst v. Snyder Gas Company (N. Y. P. S. C.), P. U. R. 1921 D 539 ..... 8%

Re: Fuel Gas Company (Ind. P. S. C.), P. U. R. 1919 C 879 ..... 7%

Re: Indiana Gas Light Company (Ind. P. S. C.) P. U. R. 1921 E 441 ..... 7%

Re: Rockford Gas Light & Coke Co. (Ill.), P. U. R. 1920 E 641 ..... 7.3%

Re: Monarch Gas Company (Ind. P. S. C. P. U. R. 1920 C 690 ..... 7%

Re: Sheridan Gas, Oil & Coal Co. (Ind. P. S. C.), P. U. R. 1921 E 7%

Re: Richmond Light, Heat & Power Co. (Ind. P. S. C.), P. U. R. 1917 B 300 ..... 7%

Consumers' Gas Co. v. Corporation Com. (Okla. Sup. Ct.), 219 P. 126 ..... 8%

Re: Billings Gas Company (Mont.), P. U. R. 1925 B 363 ..... 8%

Oklahoma Nat. Gas Co. v. Corp. Com. (Okla. S. C.), 216 P. 917 ..... 8%

Landon v. Public Utility Com., 234 Fed. 152, P. U. R. 1917 A 120 ..... 8%

Re: Utility Gas Co. (W. Va.), P. U. R. 1926 A 57 ..... 8%

Re: Point Pleasant Natural Gas Co. (W. Va.), 1927 B 805 ..... 8%

We do not think that the Court will take seriously the contention that an 8% rate of return is not reasonable in this case.

The protestants in this case contend, as will hereinafter appear, that it is the original investment which must be depreciated and not the fair value or the cost of reproduction at any particular moment. In other

words, in this case it would appear that the issue of confiscation has been met if over a period of increasing and decreasing prices the original investment of the plaintiff had been restored to it. However, it is not even necessary to rely upon this contention in order to show that no confiscation exists in the case of applicant's property in the State of Kentucky. The record shows that if the gas content estimated to be under the leases of the applicant is consumed at the same rate as it was consumed in 1923, the field of the company would be exhausted in about 18 years. (R. 1118) Leaving out of consideration, therefore, the fact that a considerable part of plaintiff's property has been in existence since 1909, but considering only the future life of the property an amortization and depreciation rate of about 5.5% would be indicated.

The West Virginia Public Service Commission in its decision involving the same applicant arrived at a composite percentage of 5.27% for depletion (equivalent to amortization) and depreciation. The District Court for the Southern District of West Virginia in deciding upon an appeal from this decision indicated that 4.77% was reasonable for depreciation and amortization (3.65% for amortization and 1.12% for depreciation). Judge Hickenlooper in his decision stated that 6% was ample for depreciation and depletion (depletion being used synonymously with amortization). He finally decided that 3½% for depletion and 1½% for depreciation, or a total of 5% would fully meet applicant's requirements. (R. 1584)

Re: Fuel Gas Company (Ind.), Case 4262, 5% was allowed for depreciation of mains and depletion of wells.

Re: Monarch Gas Company (Ind.), P. U. R. 1920 C, 960; 5% was held to be reasonable for depreciation and depletion.

Amhurst v. Snyder Gas Company (N. Y.) P. U. R. 1921 D, 539; the Commission held that 5% was a reasonable allowance for depreciation of the physical property and 3% was sufficient for depletion of natural gas wells.

Okmulgee Gas Company v. Corporation Com. (Okla. Sup. Ct.) P. U. R. 1924 B, 249; 5% was held to be reasonable.

Re: Payne County Pipe Line Company (Okla.), P. U. R. 1924 E, 481; 5% was allowed.

Re: West Virginia Central Gas Company (W. Va.), P. U. R. 1924 E, 24; 5% was allowed.

Antioch v. Boyles (Ohio), P. U. R. 1925 E, 152; an allowance of 5% was made.

Municipal Gas Company v. Sherman (Texas), P. U. R. 1925 E, 67; 2½% was allowed as reasonable.

Bearing in mind that applicant's property was first placed in operation on any extensive scale in 1909, it can be readily seen that there was a considerable expired life at the date of the inquiry, that is December 31, 1923. That portion of the property which was in existence in 1909 (representing substantially all of the gas rights of the company) was 14 years old at the time of the inquiry and it had 18 more years of useful life, considering such useful life as being ended when

the gas fields are exhausted. The entire life cycle of the property, is therefore, about 32 years. After making some allowances for additions recently made, it is inconceivable that the composite life of the property, that is considering its expired life and its future expected life, would be less than 25 years. A depreciation and amortization (depletion) provision of more than 4% is, therefore excessive. Conceding for the sake of argument, however, that five per cent is necessary to return every dollar of value (not original investment) to the applicant, and adding to this a reasonable return of 8%, an over-all rate of 13% will certainly cover every measure not only of confiscation but of reasonableness.

As already indicated, the undisputed evidence in the record is that the net earnings applicable to Kentucky business in 1923 amounted to $749,839. (R. 1421) The only question which can be raised as to these net earnings is that relating to the value of the gasoline extraction privilege. The point on gasoline will be covered on pages 32 to 52 of this brief. Applicant in its brief on page 56 used these net earnings for the purpose of illustrating its own position on the point of confiscation.

If 13% is ample for depreciation, amortization and return, that percentage will be sufficient to pay a return of 8% on, and to restore to the owners at the end of the useful life of the property, a value for property in the State of Kentucky of $5,760,000. If the Court, by considering the various elements of value, cannot arrive at a fair value in excess of this amount, there certainly cannot be any confiscation in this case.

For the purposes of making a demonstration of this character, we can concede every contention with respect to value on the part of the applicant and still there will be no confiscation as relating to the property of the applicant in the State of Kentucky.

The basis of allocating the applicant's property have been fairly definitely determined in the West Virginia cases. They were accepted by the applicant in the District Court in a case involving this applicant which is now before this court and is being presently heard. (See Judge Rose's decision in United Fuel Gas Company v. the Public Service Commission of West Virginia.) These basis of apportionment are for the production system, the sales basis; for the transmission system, the system demand mileage basis; for the distribution system, the distribution property actually located in Kentucky; for the general and overhead expenditures, the overhead basis; for working capital the expense basis; and for going concern value, the overhead basis.

Accepting the estimate of applicant's engineer as to the cost of reproduction new less depreciation ($28,631,320) and adding thereto the undisputed amount for working capital ($990,000) and also the only supported estimate of going concern value ($3,000,000) and allocating to the State of Kentucky its proper proportion of these items of value, we secure the total value thereof assignable to that state of $3,171,122. This allocation to the State of Kentucky is shown in the accompanying table.

TABLE A

TOTAL PROPERTY:	
Production System (Exclusive of Leaseholds)	$ 7,830,400
Transmission System	11,154,326
Distribution System	2,694,806
General Property	594,742
Total Specific Cost	$22,274,274
General Overhead Charges	6,357,046
Total Reproduction Cost less Depreciation for Physical Property	$28,631,320
Working Capital	990,000
Going Concern Value	3,000,000
Total Physical Property, Working Capital and Going Concern Value	$32,621,320
PORTION OF ABOVE ASSIGNABLE TO KENTUCKY:	
Production System (Exclusive of Leaseholds) (1)	$ 545,779
Transmission System (2)	1,146,665
Distribution System (3)	421,012
General Property (4)	57,987
Total Specific Cost	$ 2,171,443
General Overhead Charges (4)	619,812
Total Reproduction Cost less Depreciation for Physical Property	$ 2,791,255
Working Capital (5)	87,367
Going Concern Value (4)	292,500
Total Physical Property Working Capital and Going Concern Value	$ 3,171,122
Composite Percentage	9.72%

Notes:

(1) Apportioned on the basis of Kentucky sales to total sales—6.97%.

(2) Apportioned on basis of Kentucky's proportion of system maximum demand properly weighed for distance of Kentucky business from center of the field—10.28%.

(3) No apportionment necessary—Uebelacker Exhibit 1 R 1041 shows Distribution Property physically located in Kentucky which has been included at 100% in above.

(4) Distributed in same relation as that indicated for all items immediately preceding.

(5) Apportioned on the basis of Kentucky retail proportion of total expenses—operating expenses largely govern amount of working capital.

Additional Note:

All of these apportionment bases used in Jirgal Exhibit 1 A R. 1420 and approved by West Virginia Commission and District Court for Southern District of West Virginia—Also accepted by Plaintiff in that case.

If there is accepted by this Court the applicant's contention of a $30,000,000 valuation for its leaseholds (see page 55 of applicant's brief) there would be assignable to the State of Kentucky 6.97% of this amount or $2,091,000. The total value assignable to the State of Kentucky would, therefore, be $5,262,122 (arrived at by adding $3,171,122 to $2,091,000). If the highly excessive value of $35,000,000 is assumed for the lease-

holds and 6.97% thereof is assigned to the State of Kentucky, only $2,339,500 can be charged to applicant's business in that state. Adding to this the $3,171,122 for the other elements of value, a total value of only $5,510,622 is arrived at. Therefore, on the basis of allowing $30,000,000 for the leaseholds and $35,000,000 for such leaseholds, the total value for all elements of property assignable to the State of Kentucky is less than the value arrived at by capitalizing the undisputed net earnings available for depreciation and return at 13%.

The Court will recall that the value arrived at by this capitalization basis is $5,760,000. On the basis of allowing $30,000,000 for gas rights, the amount of applicant's property assignable to Kentucky is $5,262,122. On the basis of $35,000,000 for the rights, the amount of applicant's property assignable to the State of Kentucky is $5,510,622.

PLAINTIFF SETS UP KENTUCKY DISTRICT VALUATION INSTEAD OF THAT USED AND USEFUL IN SUPPLYING KENTUCKY CITIES.

In view of these results, the court may well ask why the demonstration above differs from that shown by plaintiff on page 56 of its brief. The explanation is simple. Plaintiff in its brief on page 55 arrives at a value of $7,156,357 as applicable to Kentucky, and relating this sum to the total appraised value as found by Mr. Uebelacker, it is concluded by plaintiff that 11% of the total property is assignable to the retail business in Kentucky. It is entirely wrong to use this valuation amount in this manner, for the

reason that such valuation amount covers the property physically located in Kentucky instead of the property used and useful to supply Kentucky retail business. The amount of property used and useful for Kentucky retail business can only be arrived at by considering the entire property of the companies involved (United Fuel Gas Co. and Warfield Gas Co.) and allocating same on some reasonable basis to each class of business, including the business done in Kentucky. Reference to the map at R. 1054 will show that a considerable amount of the investment of the company in the state of Kentucky is used for the purpose of supplying other portions of the company's business than the business at Ashland, Catlettsburg and other Kentucky retail districts. To charge the Kentucky business with the value of all the property within that state amounts to an assessment to the Kentucky consumers for purposes other than supplying their particular service. For instance, part of the transmission lines located in Kentucky are used in supplying the wholesale consumers, deliveries to which are made at Inez, Kentucky, and some of the acreage and gathering lines in Kentucky are also used for this purpose. Mr. Uebelacker, in his exhibit No. 1 (R. 1039) and his testimony (R. 809-812) indicates clearly that the $7,156,357 which he assigns to Kentucky covers property physically located in that state and that it has no reference to the used and useful property for Kentucky retail business.

Protestants challenge the right of the plaintiff to place any other interpretation on this valuation amount than the one given above. That this conclusion is proper is evidenced by the fact that plain-

tiff in its bill of complaint (R. 10) fixes the present fair value of the property applicable to Kentucky retail business at $5,000,000. The valuation which is now claimed is over forty per cent higher and, as already stated, is erroneously contended for.

In view of the fact that, as already shown, the company is earning on a valuation of $5,760,000 arrived at by the capitalization method, it is surprising that the plaintiff should raise any claim as to confiscation on that part of its business which applies to the retail consumers in the state of Kentucky. However, protestants in this case claim that no such value as the $5,000,000 set forth in the bill of complaint can be arrived at by considering the separate elements of physical property, working capital, going concern value and gas rights. Protestants will show in the course of their arguments that the total value of the property assignable to Kentucky retail business can not, by any stretch of the imagination, be shown to be in excess of $3,700,000.

Before approaching the question of valuation, however, the protestants in this case desire to state for the court that no such valuation as $5,760,000, even on the capitalization basis, is conceded. That valuation amount is arrived at by capitalizing the undisputed net earnings (except for the gasoline question) at 13 per cent, it being clear that the applicant is not entitled to more than 8 per cent for return and 5 per cent for depletion and depreciation. By adopting this method, protestants merely show that on the basis most favorable to the applicant, no confiscation of property is evident.

The adoption of this method of proof assumes that the plaintiff is entitled to depreciate and amortize its property at the present fair value instead of the original cost thereof, and it also assumes that the leasehold rentals and leasehold expenses should properly be borne by the consumers, two propositions to which protestants make definite exception, as will hereinafter appear.

The true valuation on which plaintiff is earning a reasonable return as applying to Kentucky retail business.

As already noted above, the protestants claim that it is the original cost of the property which is to be depreciated and depleted (latter equivalent to amortization) and not the fair value of such property, and protestants also take the position that if appreciation is to be allowed in determining leasehold values, the operating expenses should not include the delay rentals and leasehold expenses necessary to carry the gas acreage now covered by lease.

Plaintiff has already referred to the net earnings of $749,839 as applying to Kentucky retail business. If from these net earnings there be deducted the amount found necessary to keep intact the original investment of the company through annual depreciation and depletion allowances, and if there be added to the resulting amount the sum already included for delay rentals and leaseholds expenses, there will be reflected the net earnings upon which plaintiff is earning a reasonable return for its Kentucky retail

business. Protestants' position in this respect is set forth in the following table:

Net Earnings shown as per company's books except for an adjustment for gasoline credit amounting to $65,166 (R. 1424)	$749,839
Amount of $1,399,227 allowance for depletion and depreciation computed on original cost assignable to Kentucky retail business (R. 1565)	122,703
Net Earnings after deducting leasehold rentals and leasehold expense, available for return on investment	627,136
Add Back Kentucky retail portion of Delay Rentals and Leasehold Expense 6.97% of $589,186 (R. 1436)	41,066
Net Earnings available for Return	$668,202

It has already been demonstrated that 8 per cent is a reasonable return for natural gas properties, and on this basis the $668,202 of earnings shown above will support a valuation of $8,352,525. If it can be demonstrated to the court that this valuation is based upon sound reasoning in respect of the net earnings, certainly no confiscation can be alleged, for the plaintiff's bill of complaint claims only a $5,000,000 valuation for the Kentucky retail business, and even on the erroneous basis set forth in the brief, a valuation of only $7,156,357 is claimed.

There are only three questions involved in a determination as to whether the above statement of

net earnings is a proper one. These questions relate to the following subjects:

(1) The proper credit for the value of the gasoline extraction privilege.

(2) The basis on which the annual allowances for depreciation and amortization should be calculated—whether on fair value or original cost.

(3) The propriety of including lease rentals and lease expenses in operating costs.

Each of these matters will be discussed in the following paragraphs.

The proper credit for the value of the gasoline extraction privilege.

In order to approach the gasoline question, it is necessary to understand something about the nature of the natural gas gasoline business and its history, as applied to the instant case.

The United Fuel Gas Company, in 1916, started to extract gasoline from natural gas by processes developed at that time. The gasoline equipment by which this extraction is undertaken is installed along the transmission lines of the Company, for the most part, near its compressor stations. The gas flows from the field through the transmission pipes, and through the compressor and gasoline stations, and is again delivered to the transmission system for transportation to its ultimate destination. There is, therefore, joint use made by the gas and gasoline departments

of certain facilities of the Company up to the gasoline extraction plant. If an independent gasoline producer wished to extract gasoline without entering into the business of selling gas for commercial and industrial purposes, he would of necessity have to provide these facilities in order to secure the gas which is necessary in the extraction process. In other words, he would have to invest in gas acreage, gas wells and the necessary gathering and transmission pipe lines in order to bring all of his gas to the gasoline plant. He would of necessity have to incur the royalty payments on the gas, delay rentals on his leaseholds held in reserve, the cost of operating and maintaining the well supply and the cost of operating and maintaining the gathering lines and transmission system. A number of independent gasoline producers do this very thing.

Because of the fact that the appellant, in rendering its public utility service, already has these facilities, it is possible for the two departments to use them jointly instead of each one having a separate system. The joint facilities, therefore, result in economy in that they serve both departments. This joint use of the particular facilities referred to calls for the proration of the joint investment and expenses.

In the extraction process the primary essential is the gas itself. In view of the fact that it has been possible to date to extract gasoline from natural gas at a very much cheaper cost than to extract the same from crude oil by the so-called "cracking" process, the extraction privilege is very valuable.

The Record shows (R. 888) that over 90% of the gasoline comes from the crude oil extraction process,

so that the price of the product is governed by the cost of production of the crude oil gasoline produced. Since the costs of this crude gasoline production have been much higher than the extraction costs of the natural gas gasoline production, the value of gas, which is the raw material for the latter production, has reflected this condition by an increase in its value for this purpose.

From 1916 until May, 1922, the United Fuel Gas Company extracted this gasoline from its natural gas directly, but as of the latter date the Virginian Gasoline & Oil Company was organized and there was conveyed to this Company all of the gasoline property of the United Fuel Gas Company, practically all of its oil property and the gasoline extraction privilege applying to all of its gas. The consideration was the delivery to the United Fuel Gas Company of all the stock of the Virginian Company, the assumption of a certain proportion of the United Fuel Gas Company's funded debt, and an agreement on the part of the Virginian Company that it would pay to the United Fuel Gas Company one-eighth of the gross proceeds from the sale of the gasoline extracted from the gas. Upon receiving the stock, the United Fuel Gas Company distributed the same to its two stockholders referred to herein as the "Parent Companies." The Virginian Company, therefore, is an affiliated company of the United Fuel Gas Company through the ownership of its stock by the Parent Companies of the United Fuel Gas Company. By this contract the United Fuel Gas Company recognized the principle that payment should be made for the use of the gas in the gasoline extraction process. The

only question before the Court, therefore, is whether the compensation for the use of the gas as provided for in this agreement is sufficient to recognize:

(a) The joint use of the facilities involved, and

(b) The full value of the extraction privilege as measured by ordinary principles governing the valuation of such privileges.

This question has been decided in West Virginia in a number of cases involving the applicant from 1917 to date, and it has been uniformly held in that state that the value of the gasoline extraction privilege is properly measured by taking 50 per cent of the net earnings derived from the gasoline end of the business. (See Case No. 585, 1 P. S. C. W. Va. 501, P. U. R. 1918 C, 193; Case No. 845, 1 P. S. C. W. Va. 651, P. U. R. 1920 C, 583; and subsequent cases.)

The West Virginia Public Service Commission also made the same decision in cases involving other applicants. (See In Re: Hope Natural Gas Co. P. U. R. 1921 E, 418.) The West Virginia Public Service Commission did not apply this rule arbitrarily, as might be presumed, but found on the contrary that two parties dealing at arm's length in that state (that is, the Eastern Oil Company and the Hope Natural Gas Company) had established that 50 per cent of the gross earnings from the gasoline business furnished a reasonable valuation basis for the extraction privilege. See In Re: Hope Natural Gas Company, P. U. R. 1921 E, 429.)

It will be noted that this contract between the Eastern Oil Company and the Hope Natural Gas Company is based on gross earnings, and therefore a larger amount is paid for the extraction privilege than would have been paid, were only 50 per cent of the net earnings applied in ascertaining such value.

The plaintiff hoped to avoid the effect of these decisions by organizing in 1922 the Virginian Gasoline [illegible] (See City of Charleston, et al. v. Public Service a stock dividend after its formation to the two Parent Companies of the United Fuel Gas Company. As an incident to the formation of the Virginian Company, the United Fuel Gas Company made a contract with that corporation whereby, among other things, the Virginian Company was to have the exclusive right to extract gasoline from the natural gas produced by the plaintiff, in return for which privilege it was to pay the plaintiff one-eighth of the gross proceeds from the sale of gasoline manufactured.

Shortly after the formation of the Virginian Company, the present plaintiff had a rate case before the Public Service Commission of West Virginia, in the decision of which case the Commission held that this contract was valid and that one-eighth of the gross proceeds was a reasonable compensation for the extraction privilege. The protestants in that case appealed from the decision of the Commission to the Supreme Court of Appeals of the state of West Virginia (See City of Charleston, et al v. Public Service Commission, 95 W. Va. 91.) That Court held, after studying the evidence, as follows: (P. 127)

"We think the extraction privilege is worth at least 50 per cent of the net profits, and that proportion should be charged to the gas business."

In a case similar to the one before this Court involving the West Virginia end of plaintiff's business, Chairman Stathers of the West Virginia Public Service Commission (R. 130, W. Va. Record) decided as follows:

"Our examination leads us to the conclusion that under the facts in this present record, considered together with the facts in the record of Case No. 1251, we must reach the same conclusion as that at which the Supreme Court of Appeals arrived. The record supports and compels a finding agreeable to said holding, so that, using the language of the Court, we think the extraction privilege is worth at least 50 per cent of the net profits, and that proportion should be charged to the gas business."

The case referred to immediately above was appealed to the District Court for the Southern District of West Virginia, and in that case Judge Rose, who wrote the opinion, made the following finding on the gasoline question:

"We do not find it necessary to consider whether the issue there passed on is now res adjudicata because even if it is not, we are as to it of one mind with the highest court of the State." (United Fuel Gas Company v. Public Service Commission, 14 Fed. (2d) 212.)

Judge Hickenlooper, in the present case, decided that 50 per cent of the net profits provided "a most generous return on the value of the property used for extraction purposes" and was "in no wise unreasonable." (United Fuel Gas Company v. Railroad Commission of Kentucky, 13 Fed. (2d) 510.)

Quite apart from the matter of precedent, however, the protestants contend that the finding of the District Court as to the value of the gasoline extraction privilege, is amply supported by the evidence which was presented to it in the present proceeding. Two points developed by the evidence call for the special consideration of this Court:

1. The joint use of the facilities by plaintiff and the Virginian Gasoline and Oil Company.

2. Valuation of the extraction privilege, as measured by ordinary principles governing the valuation of such privileges.

Mr. Jirgal, witness for the protestants, gave as his reason for crediting 50% of the gasoline net profits to the Gas Department the following (R. 855):

> "That the reason for assigning one-half of the net profits from the gasoline business to the natural gas business, is that, in the first place, there is a joint use of facilities. The gas is taken out of the ground from an acreage that costs the company money; that gas is transmitted or gas is also taken out of the ground through wells that also call for an investment; the gas is piped to the gasoline station; the acreage which is

called upon to yield the gas costs the company considerable every year in rentals, for which the gas department is assessed; royalties are paid; it costs something to operate and build a transmission system, and that would seem to call for a division of those items between the two projects. The exact amount of the money is rather difficult to ascertain, but some division it would appear to have to be made. The cost accounting principle is not to consider one of two major products as a residual product, and the other as bearing all the cost. Some fair division has to be made between the two major products. Now then, looking at it from the purely economic side, you have this situation, that from 90 to 95 per cent and possibly more of the gasoline in this country is manufactured from the crude oil refining process. That means that the crude oil refinery will, in a fair competitive market, determine the price because it will be that cost of production which will determine the price on which they can sell their gasoline at a profit. Now, that makes it a question of relative costs between the natural gas gasoline process, or the natural gas extraction process and the crude oil process, and as long as there is a differential the natural gas producers will get the difference in profit. Now you are giving him a very large differential advantage, when you do not assign him a very large differential advantage, when you do not assign any costs at all for the raw product he uses in the manufacture, and that is natural gas. In the crude oil process, as I understand it, there are a great many economies being perfected, and the cracking process I understand is being made more efficient. That means that the margin between the natural gas extraction process and the crude

oil process will decrease, if the natural gas process does not also become more efficient. Now the records of the company show, as I recall them, that each year there is a gain in the amount or yield per thousand feet, which goes through the gasoline extracting station. So it shows that that method is becoming more efficient, but it is a question as to which process is becoming relatively more efficient. Anyone going into the question of extraction from natural gas would therefore be willing to pay the natural gas producer that price which would allow him to meet the crude oil refiner's price. In other words, he would pay that much more for the natural gas rights or for the right to extract from natural gas the amount represented by the difference in his cost of production and the cost of production by the crude oil refiner. He wouldn't pay absolutely that differential, because he would be taking all the risks of the manufacturer and he would be taking the risks over a series of years, and of course he would want some leeway because he wouldn't want to take all the risks and get nothing of the gain going into it; but that would be the principle that would determine how much he would pay for that right. Now, in the previous hearing I have attempted to show, from figures of the Federal Trade Commission, that that right would be more valuable than the fifty per cent. Whether or not these figures would obtain at this time, I am not able to say, but the principle would govern just the same, and if there is no differential there would be nothing to split. I think the question is merely a question of determining a fair basis for paying for the right or privilege of extraction to the natural gas producer."

Jirgal credited 50% of the net earnings of the gasoline end of the business to the Gas Department in all of the exhibits presented before the Commission. It appears (R. 1503) that he had previously made a study of specific data from the bulletins of the Federal Trade Commission, which show that the privilege of extracting gasoline from gas was worth at least three cents per thousand cubic feet, which, based on the sales, sustained a credit of more than 50% of the gasoline net earnings.

Mr. Krebs, a consulting geologist and mining engineer of Charleston, who testified with respect to contracts between parties dealing at arm's length, with which he was familiar provided for the extraction of gasoline from natural gas stated, that it was his opinion that the value of the extraction privilege was at least 50% of the net profits from the sale of the gasoline. (R. 972)

Mr. Hagenah, for the protestants, by his "Exhibit No. 9" (R. 1563), showed an assignment to the gasoline department of its proportion of the joint investment and expenses.

This exhibit of Mr. Hagenah's is, we submit, conclusive that the 50% division of the gasoline net earnings is more than liberal to the applicant. Mr. Hagenah showed that the total joint expenses $607,-562.00 was assignable to the gasoline department, and that of the total reproduction cost less depreciation of the joint physical property $5,185,939.00 was assignable to the gasoline end of the business. Using these findings of Mr. Hagenah as a basis, the expenses of

which the gas department should be relieved by the gasoline department would be as follows:

Operating expenses	$ 607,562.00
Fixed charges (on gasoline proportion of joint property ($5,185,939.00) representing depreciation, amortization and return of 8% on investment—all estimated at 13.27% by the Commission)	688,174.00
Total Gas Department Costs Assignable to Gasoline Department	$1,295,736.00

On the basis of this statement of expense allocation the Commission very properly could have credited to the gas department $1,295,736.00 instead of its credit of $934,393.00 a difference of $361,343.00.

Jirgal's Exhibit "No. 8" (R. 1503) shows that for the year ended December 31, 1923, the gasoline end of the business had net earnings of $1,868,786.82 after taking into consideration all prior charges including depreciation and federal income taxes. If from these net earnings there is deducted the $1,295,736.00 of costs which were borne by the gas department, but which should have been borne by the gasoline department the latter business would have a net earning of $573,000.00 available for return on the gasoline investment of $1,167,397.00, or over forty-nine per cent.

That a credit of one-half of the gasoline net earnings to the gas department for the extraction privi-

lege has been more than fair to the gasoline department is shown by "Jirgal's Exhibit No. 8" (R. 1503), which is summarized below:

Year	Investment In Gasoline Plant at End of Year	50% of Gasoline Net Earnings Retained by Gasoline Department	Per Cent Return on Investment Earned by Gasoline Department after paying 50% for Extraction Privileges
1916	$ 279,980.77	$ 127,676.13	45.60
1917	437,678.87	662,446.51	151.35
1918	525,999.83	791,519.38	150.48
1919	752,970.03	1,103,637.70	146.57
1920	938,347.34	1,320,292.00	140.70
1921	989,852.22	999,587.21	100.98
1922	1,073,483.50	1,101,705.72	102.63
1923	1,167,397.25	934,393.41	80.40

In no single year since 1916 (the first year in which the extraction took place) has the return on the gasoline investment, represented by 50% of the net earnings, been less than 80.40%. It is inconceivable that in a free competitive market the Virginian Gasoline & Oil Company could earn any such profits as these, provided it paid for its gas on the basis of the full value of the gasoline extraction privilege. The District Court, therefore, has been exceedingly liberal in valuing the gasoline extraction privilege at only 50% of the gasoline net earnings.

The only serious contention, apparently, made by the plaintiff relative to the gasoline credit is that it is

abnormal. In other words, the claim is made that the credit of $934,000.00 made by the District Court will not represent the normal credit which can be expected on this account. This contention is answered by the statement introduced immediately above, in which it is shown that in no year since 1919 has the 50% credit amounted to less than that amount ($934,393.41). As to applicant's contention that the 50% rule results in a fluctuating credit, the Court has only to review the amounts for the last five years to see that such fluctuations are not any greater than could be expected in normal operations of any business of this character. Protestants claim that the fluctuations have not been so marked that the Commission could not rely upon the application of its rule in determining the proper amount of the credit.

While the credit applicable to the year 1924, as shown by the record (R. 1563), is lower than many of the preceding years, the testimony of Mr. Hagenah showed that the gasoline conditions in that year were not abnormal, but subnormal (R. 932). The data already introduced above shows that this is the case.

It ought to be significant to the Court that none of the West Virginia Public Service Commissioners nor the District Court for the Southern District of West Virginia nor the District Court for the Eastern District of Kentucky questioned the fairness of the 50 per cent division.

The Kentucky Commission, in its amended answers set up that the gasoline extraction privilege should be worth one-half the net earnings or at least

3 cents per thousand cubic feet for all gas treated. (R. 754)

These allegations as to the value of the gasoline extraction privilege were never denied. Judge Hickenlooper, in discussing the value of this privilege, among other things, said:

> "Viewing the gasoline as a pure by-product of the natural gas business, we are of the opinion that earnings should be increased, or operating expenses decreased, by some fair apportionment of the earnings from this branch of the business. Considering the greatly increased and increasing production of gasoline from natural gas since 1917, it is to be assumed that the earnings from this source have not permanently decreased in volume but that the results of the years 1923 and 1924 are more or less temporary depressions in earning power. We are of the opinion that the application of one-half of the net earnings to the gas business is in nowise unreasonable, since this will also afford a most generous return on the value of the property used for extraction purposes. In previous years this would amount to not less than 2 cents per thousand cubic feet of gas treated, and even in the year of 1924 would exceed 1 cent per thousand cubic feet of gas so treated. To this extent the costs of production are decreased, or the return from such production increased." (R. 1581)

We do not see how any question can be raised as to the reasonableness of the 50 per cent allocation principle.

THE BASIS ON WHICH THE ANNUAL ALLOWANCES FOR DEPRECIATION AND AMORTIZATION SHOULD BE CALCULATED —WHETHER ON FAIR VALUE OR ORIGINAL COST

Judge Hickenlooper, in his decision (R. 1580) held that the investment value was the proper basis for depleting plaintiff's property, but he also held that the smaller part of the allowance covering depreciation should be figured on fair value.

Protestants in this case claim that depreciation and depletion should be calculated on the original cost of the property for the reasons set forth by Jirgal (R. 876) as follows:

(1) The purpose of the depreciation and amortization reserve is to keep the investment intact, and not to return to the investor the cost of reproduction at any given valuation date.

(2) The original cost is the common basis for calculating depreciation and depletion in order to compute profit in all industry. (R. 876)

(3) The applicant may use the difference between the allowance for depreciation and amortization computed on fair value and such allowance computed on cost, as additional profit available for dividends, so that the Commission's allowance for these items on this basis is in effect giving the company an additional return over and above the eight per cent found by it as reasonable. (R. 876)

(4) The classification of accounts adopted by Public Service Commissions generally, and by the West Virginia Public Service Commission for natural gas companies, provides that depreciation shall be calculated on original cost. The following is an extract from the West Virginia classification relating to natural gas companies:

> "In determining its rate of depreciation the utility, shall in the case of those structures and items of equipment that can be satisfactorily individualized, provide for each such structure and item of equipment an amount which will through regular accumulation insure at the time such structure or item of equipment goes out of service a reserve therefor equal to the **original money cost thereof** less salvage recovered thereon. In the case of those structures and items of equipment that can not be satisfactorily individualized the utility shall keep such structures and equipment in efficient condition through repairs, and shall treat all renewals or replacements of parts thereof as repairs" * * * * * and,
>
> "Credit to this account and charge to amortization of franchises, patent rights and licenses accounts those amounts which, through regular application, will provide at the expiration of the lives of the utility's limited franchises, patent rights and licenses, limited rights of way, and *leaseholds*, a reserve equal to *their original money cost.*"

West Virginia, R. 402-3, Case 79.)

(5) The company loses nothing by this method of calculating depreciation and amortization, because the difference between the original cost of property retired from service and the cost of the property by which it is replaced, is added to its capital account.

(6) Public utility mortgages commonly provide for this basis of withdrawing additional bonds from time to time (West Virginia R. 402-3, Case No. 79).

(7) To compute depreciation on any other basis than original cost results in a fluctuating basis for computation which cannot be used practically by the company in its records every time the price level changes.

Mr. Hagenah takes the same view with respect to the basis for calculating depreciation. He points out that the purpose of the reserve is to maintain intact the integrity of the investment, and, further, to protect the investor in the actual cost of the property he has devoted to the public use. He further states that the utility is not to be protected on any such speculative basis as is brought about by changes in the price level. He brings out very forcibly that the reserve cannot be applied on any uncertain or fluctuating principle, and that appreciation should not be retired though a depreciation reserve which is, in effect, what is done if cost of reproduction is used as a basis for calculating depreciation and amortization allowances. (R. 934)

In Exhibit 2A (R. 1422), Jirgal sets forth that an annual allowance of $1,399,227 is ample for the property as a whole, and that the proportion applicable to Kentucky retail business amounts to $122,703.

The West Virginia Public Service Commission in its recent decision already referred to, shows that an annual average expenditure of $203,463 has been incurred in the last fourteen and one-half years for realized depreciation, so that there is available for return of capital out of the aforesaid allowance of $1,399,227, the amount of $1,195,764.

The property of the plaintiff has been in existence for fourteen years and the evidence shows that it has a remaining life of eighteen years additional. If this amount of $1,195,764 had been applied uniformly throughout the 32-year life of the property, a reserve of $38,264,448 would have been built up. Bearing in mind that the original cost of plaintiff's property as shown by this record is $26,288,912 (See Jirgal Exhibit No. 1—(R. 1405), and that the retirements of property from 1909 to 1923 inclusive have been $2,950,222.32, it will be seen that the allowance on an original cost basis is more than sufficient to keep intact the investment of the plaintiff.

Protestants contend that this allowance is too liberal for the reason that it does not take into consideration the large element of salvage value which is existent in the property, and it also does not take into consideration that the annual amounts set aside for depreciation and depletion will earn interest. According to standard tables, an annual allowance of $1,195,764, if placed at 6 per cent for only the remaining eighteen years of life, would amount at the end of that time to $36,955,867. The balance in a depreciation and depletion reserve at December 31st, 1923, on a properly calculated basis, would have resulted, when

added to the foregoing amount, in a balance of $76,998,639 at the end of eighteen years which is in excess of any fair value which can be found from the present record. The calculations upon which the results above have been arrived at are shown below:

Balance $14,028,737.00 which the Public Service Commission of West Virginia shows would have accumulated to December 31, 1923, at annual allowances kept intact by plaintiffs at 6% for 18 years	$40,042,772.00
Annual net allowance of $1,195,764.00 For remaining 18 years at 6%	36,955,867.00
Total fair value which would be amortized	$76,998,639.00

Not only is the original cost basis the proper basis for computing depreciation and depletion, but it results in an amount which, when placed at a reasonable interest rate, gives a balance to the plaintiff which is in excess of the fair value claimed by it.

That the original cost is the proper basis for computing depreciation and depletion is shown from a review of the following cases:

Re: Springfield Gas & Electric Co. (Ill.), P. U. R. 1919 B 746;

Re: Southern Pacific Co. (Nev.), P. U. R. 1920 F 725, 769;

Re: Coast Gas Company (N. J.), P. U. R. 1923 A 349;

Re: Public Service Railway Co. (N. J.), P. U. R. 1921 D 953;

Re: Bronx Gas & Electric Co. v. P. S. C. (N. Y. Sup. Ct.), P. U. R. 1923 A 255;

Re: Wisconsin-Minnesota Light & Power Co. (Wis.), P. U. R. 1920 D 428;

Re: Philippine Ship Owners' Ass'n (P. I.), P. U. R. 1921 C 536;

Re: Champaign & Urbana Water Co. (Ill.), P. U. R. 1919 E 798;

Re: St. Joseph Water Co. (Mo.), P. U. R. 1924 B 338;

Re: Baird v. Burleson (N. Y., 2nd Dist.), P. U. R. 1920 D 529;

Re: LaPorte Gas & Electric Co. (Ind.), P. U. R. 1921 A 824.

The following are a few of the many cases in which public service commissions have decided that the interest earnings on the depreciation and depletion reserve should serve to reduce the annual charges against the consumer:

Re: Wisconsin Telephone Company (Wis.), P. U. R. 1926 B, 628;

Re: Southern California Telephone Company (Calif.), P. U. R. 1925 C, 627;

Re: Coos & Curry Telephone Company (Ore.), P. U. R. 1924 E, 344;

Re: Coast Valley Gas & Electric Company (Calif.), P. U. R. 1924 C, 40;

Re: Illinois Commerce Commission v. Chicago Telephone Company (Ill.), P. U. R. 1924 A, 213;

Re: Northwestern Bell Telephone Company (S. Dak.), P. U. R. 1924 E, 274;

Re: Great Western Power Company (Calif.), P. U. R. 1923 C, 545;

Re: Kootenai Power Company (Idaho), P. U. R. 1923 A, 764;

Re: Idaho Power Company (Idaho), P. U. R. 1923 B, 52;

Re: Meade, C. H., Coal Company v. Appalachian Power Company (W. Va.), P. U. R. 1923 E, 221.

Mr. Hagenah testified that interest should be calculated on the reserve. At page 936 of the record, he has this to say:

> "Now as to the first group of purely depreciation reserve, just as we find that reserve in all other continuing public utilities. There it is for the purpose of making replacements. You cannot make replacements every year on every class of property. Some has a long life and some has a short life. Assuming that the reserve provision is made with every possible care and accuracy, there must always be and will always be, in the strictly depreciation reserve, a credit balance. As to that credit balance which the company is using in its business, or, for that matter, investing in the bank or any other place, the interest which it earns should be credited to depreciation reserve, and to that extent reduce the charge against the public for operating expenses."

Mr. Jirgal pointed out in criticism of the company's book allowance that it did not provide for in-

terest on the accumulated depreciation (and depletion) reserve balance.

The question as to the basis of calculating depreciation and depletion reserves and the further question as to whether interest should be considered in such a way as to reduce the annual provision necessary to keep the investment intact, are so important as to merit the most serious attention of the Court. Plaintiff in its brief at page 51 contends that the annual depletion (amortization) provision should be 10 cents per thousand cubic feet, or $3,737,048, while protestants claim that an annual allowance of $1,399,227 is more than sufficient to keep the investment intact, and that if interest is to be calculated on the depreciation and depletion reserves, the latter allowance is highly excessive. Of course plaintiff is entirely wrong in its theory of computing its depletion (amortization) provision on the basis of $74,493,601, because, as will be presently shown, no such fair value can be arrived at by a consideration of all the evidence on value. In addition, however, the plaintiff's theory on the annual provision is so inconsistent with its theory on the accrued depreciation which is shown in the valuation of the physical property as to merit the attention of this Court. Jirgal shows in his Exhibit No. 6 (R. 1487) that the plaintiff has sold between 1909 and 1923, 558 billion cubic feet of gas out of its territory. Allowing for line losses, the amount actually taken out of the wells is without doubt in excess of 600 billion cubic feet. There are about 650 billion cubic feet of gas estimated as yet remaining in the ground, so that from the point of view of exhaustion, the property is about 50 per cent depleted and depreciated. However, plain-

tiff's witness, Mr. Uebelacker, finds that the cost of the physical property new is $37,054,425, and that the accrued depreciation determined by the use of the observation method is $8,423,105, or less than 25 per cent. The consumers are accordingly asked by the plaintiff to amortize 75 per cent of the property over the remaining years of its life, when because of actual exhaustion, about 50 per cent of the property has already been compensated for.

In order to apply plaintiff's theory to the fair value at all, it is necessary to add to the cost of reproduction new less depreciation, the amount of accrued depreciation in the property, and thus arrive at the cost of reproduction new without any allowance for depreciation whatsoever. To this amount there should be added the retirements of property which have been made since the beginning, and the resulting figure should be divided by the amount of gas already taken out of the ground and the amount of gas still in the ground. The combination of the gas taken out and the gas still in the ground, when divided into the total reproduction cost of the property which has been in existence at any time during the life of the field, will give the proper depletion and depreciation rate. It is certainly inconsistent, however, to start in the middle of the life of any property, observe its condition and then say that the consumers should keep the value intact which results from its observed condition, when as a matter of fact, consumers have already contributed through annual provisions enough to restore to the owners the larger percentage of exhaustion which has actually been shown to have taken place. Plaintiff apparently overlooks the fact that if the condition of the

property is higher than indicated by the extent of the exhaustion, consumers have annually borne the burden to accomplish this situation, in that the maintenance charges, which are a part of the operating expenses, have continuously been made a part of the basis on which the rates have been predicated. In other words, the condition of any public utility property is determined by the amount of maintenance which has annually taken place, and the expenditures for such maintenance, being a part of the operating expenses, are already incorporated in the rates of charge. If, therefore, the public utility company is allowed to compute its annual depletion and depreciation provision over the remaining life of its property, simply because of the high percentage condition found for its property, the consumers are penalized, both through the maintenance charges and through the depreciation and depletion charges.

A CONSISTENT THEORY MUST BE FOLLOWED.

The Court will readily see that the plaintiff can not follow one theory for computing the annual allowance for depletion and depreciation, and follow another theory for computing the amount of accrued depreciation which must be deducted from the cost of reproduction new in order to arrive at the cost of reproduction less depreciation.

The manner of computing the annual allowance for depletion and depreciation is properly set forth in Michigan Public Utilities Commission v. Michigan State Telephone Company, 228 (Mich.), 658, cited by the plaintiff in its brief at page 50. We call the Court's

attention to the last sentence of the quotation from this decision, which is as follows:

> "We repeat, the purpose of permitting a depreciation charge is to compensate the utility for property consumed in service, and the duty of the commission, guided by experience in rate making, is to spread this charge fairly over the years of the life of the property."

Although it holds that the fair value shall be the basis for the annual allowance it will be noted that the Court does not say that the charge should be spread over the *remaining* life of the property, but that it should be spread equitably over the *life* of the property, meaning its entire life.

All of these problems with respect to depletion and depreciation could be very easily solved if a uniform basis, such as the original cost of the property, were adopted for computing the annual provision. If the Court allows to the utility the fair value basis of computing annual depreciation, the utility makes an extra profit over and above the 8 per cent return, which is indicated by the following illustration:

Supposing that a plant cost the owners one million dollars, and has a life of ten years. The annual amount necessary to restore the capital invested would be $100,000. Suppose this plant is appraised for rate making purposes, and the fair value is found to be two million dollars. On a ten-year life basis, this fair value will require an annual depreciation and/or depletion provision of $200,000. However, the company on its books has only an investment of one million

dollars to restore, and it therefore sets up its depreciation and depletion provision on the basis of that one million dollars, and charges to its income annually only $100,000. The gross earnings of the company, however, are predicated upon rates which will restore annually to the company for depletion and depreciation $200,000, so that the company shows an added profit of $100,000, due to the fact that the public service commission, or body having jurisdiction over its rates, has computed the annual allowance on fair value instead of original cost. The company adds this $100,000 to its 8 per cent return, or $160,000, and shows a profit of $260,000 instead of such $160,000. The Court will appreciate that no company can change its computations of profit to take into consideration the constantly changing price levels. Its computation of profit must be on a stable basis, and through a period of increasing and decreasing prices, the utility should have its investment kept intact. For instance, the time for the restoration of the plaintiff's capital to the owners will not occur for eighteen years more, and if the present trend of prices continues downwards, the original cost method will certainly restore at least all of the capital which has been contributed, and such restored capital will have the same purchasing power for the owners, or perhaps even a higher purchasing power, than when the money was put into the property.

Protestants, therefor, place squarely before the Court the question as to whether confiscation actually exists if, through a period of increasing and decreasing prices, the original capital of the plaintiff is restored to it. The Court should bear in mind in this connection that the remaining life of the property is still eighteen

years, and that the purchasing power of a dollar may be as high or higher at the end of the life of the property as it was at the time the capital was contributed to the undertaking.

The protestants ask the further question of the Court as to whether any confiscation exists if the annual provision for depletion and depreciation, computed on the original cost basis and placed at interest, will restore to the owners of the property the present fair value thereof. It has already been shown that if the annual provision of $1,399,227 is placed at 6% interest annually and there are added to it the accumulated provisions in the past, there will have been provided through this source enough money to amortize any fair value which is claimed by the plaintiff, and in fact, a much higher fair value than protestants claim can be shown from the record.

Protestants claim that the original cost is the only basis which will equitably spread over the life of the property the total amount to be depreciated or depleted (amortized) by equalizing the annual allowances, and that an annual allowance of $1,399,227 is more than sufficient to keep the investmenet intact. In fact, is more than sufficient to return to the plaintiff any fair value which may reasonably be found from the evidence in this case.

The interest bearing theory is generally applied to mine valuation, as witness the following citation from the Honorable Herbert C. Hoover's book, "Principles of Mining," quoted from page 42:

> "Therefore, before the yield on a mine investment can be determined, a portion of

the annual earnings must be set aside in such a manner that when the mine is exhausted the original investment will have been restored. If we consider the date due for the return of the capital as the time when the mine is exhausted, we may consider the annual installments as payments before the due date, and they can be put out at compound interest until the time for restoration arrives. If they be invested in safe securities at the usual rate of about 4%, the additional of this amount of compound interest will assist in the repayment of the capital at the due date, so that the annual contributions to a sinking fund need not themselves aggregate the total capital to be restored, but may be smaller by the deficiency which will be made up by their interest earnings. Such a system of redemption of capital is called 'Amortization'."

The Propriety of including lease rentals and lease expenses in operating costs.

The delay rentals and leasehold expenses expended in the year 1923 to preserve plaintiff's gas leases amounted to $589,186.00 (R. 1436). This amount was included in the operating expenses for that year and deducted from earnings. The question as to the propriety of including these items in operating expenses has been referred to in another part of this brief. It has been noted already that the only basis on which confiscation can be claimed in this case is on the theory that the full value of the gas rights contended for by the plaintiff should have been allowed by the District Court. It will appear later that there was practically no dispute before the District

Court as to the value of the physical property, the going concern value, or the working capital. If the entire amount of appreciation in the gas rights claimed by the plaintiff is necessary in order to prove confiscation, and it be assumed for the present that it is entitled to such full appreciation, then we submit it cannot equitably include in the operating expenses, any item which is in the nature of a carrying charge on the element of property for which such full appreciation is claimed. To allow the items of delay rentals and leasehold expense to remain in the operating expenses is to charge the consumers for the full appreciation in plaintiff's property, and in addition to assess them with the cost of acquiring and holding the property. Plaintiff occupies the anomalous position of one who, after contracting to sell property to another and collecting part of the purchase price from the purchaser in possession, attempts to continue to collect rent for the same property as if it were still his own.

If the consumers pay the carrying charges in addition to bearing the depreciation, amortization and fair return, they are not only paying a fair return on the appreciated value but are also permitting the plaintiff to charge them with the cost of the appreciation.

The protestants, in their exhibits before the District Court, did not deduct rentals and carrying charges for the reason that they claimed that the book cost of the leaseholds, and not their appreciated value, should be taken as the fair value thereof.

Conclusion arrived at by capitalizing plaintiff's earnings on the basis of a reasonable return.

If protestants' position on the question of the gasoline credit, the basis for computing depreciation and depletion, and the exclusion of leasehold rentals and expenses is sustained by this Court, the proper statement of net earnings will be as follows:

Net Earnings shown as per company's books except for an adjustment for gasoline credit amounting to $65,166 (R. 1424)	$744,839
Amount of $1,399,227 allowance for depletion and depreciation computed on original cost assignable to Kentucky retail business (R. 1565)	122,703
Net Earnings after deducting Leasehold rentals and leasehold expense, available for return on investment	$627,136
Add Back Kentucky retail portion of Delay Rentals and Leasehold Expense 6.97% of $589,186 (R. 1436)	41,066
Net Earnings available for Return	$668,202

On the basis of these earnings which protestants claim are properly stated, the plaintiff is earning in the State of Kentucky an 8 per cent return on $8,352,525, when such earnings are applied to the retail business only. The Court's attention is called to the fact that the bill of complaint claims only a valuation of five million dollars as applicable to this class of business, while protestants will undertake to show in the paragraphs immediately following that a valuation for this class of business in excess of $3,700,000 is not

sustained by the evidence. This brings up the necessity for considering the valuation of separate elements of property, including gas rights, physical property, working capital and going concern value.

THE FAIR VALUE OF PLAINTIFF'S PROPERTY

The record shows that the main question at issue in connection with the fair value of plaintiff's property relates to the valuation of its gas rights. The parties at interest have agreed on the amount of the necessary working capital ($990,000). They have not entirely agreed on the reasonable amount for going concern value, but the bill of complaint makes no specific objection to protestants' claim for this item of $3,000,000. The parties have disagreed to the extent of $4,662,140 in ascertaining the value of the physical property, i. e., the pipe lines, meters, wells, distribution systems, etc. (Mr. Uebelacker, plaintiff's witness, claims $28,631,320 for these items, while Mr. Hagenah claims that their value is only $23,969,180.).

VALUE OF GAS RIGHTS

In connection with the gas rights, however, there is a marked difference as to the value contended for by the plaintiff and by the protestants. The protestants take the position that Judge Hickenlooper was entirely right in deciding that there was no competent testimony introduced by the plaintiff to indicate that there had been any appreciation in leaseholds over and above their investment cost of $6,732,920. Plaintiff claims on the other hand that the testimony not only supports

appreciation for these leaseholds over and above investment cost but that such testimony supports a finding of value for these gas rights of not less than $30,000,000.

Protestants rely in the making of their case on two fundamental propositions as follows:

> (1) That plaintiff's testimony on the value of the gas rights was not directed to the ascertainment of such value on the kind of property which it owned, i. e., leasehold rights to explore for and extract gas, and
>
> (2) That the testimony of plaintiff's witnesses, even if it were pertinent to the valuation question at issue, was based on factors which had no foundation in fact.

If these two points can be demonstrated to the satisfaction of the court, then no confiscation can certainly be shown in this case. Protestants claim that there will be no confiscation even if the proof were sufficient to sustain a finding of $30,000,000 for these gas rights as is shown at the close of this brief but, of course, do not recognize any such valuation.

THAT PLAINTIFF'S TESTIMONY ON THE VALUE OF THE GAS RIGHTS WAS NOT DIRECTED TO THE ASCERTAINMENT OF SUCH VALUE ON THE KIND OF PROPERTY WHICH IT OWNED

The questions involved in the valuation of gas rights are not as complicated as would appear at first sight. The first point contended for by the protestants

is that plaintiff's witnesses on leasehold or gas right valuations did not direct their attention to the character of the property owned by the plaintiff. The plaintiff owns a leasehold right to explore for and extract gas when found and it is this right which should have been valued and not the gas content which is assumed to underlie the acreage which plaintiff has under lease. This is a fundamental distinction between protestants' case and that of the plaintiff. As will be presently shown, the plaintiff does not own the gas under the leases.

On the contrary, this gas is owned by the lessor until it has been discovered by the lessee. This is the law in West Virginia where most of the rights are located. (Hadley v. Hoopengarner, 60 W. Va. 626.)

In that case the court says:

> "The ordinary oil and gas lease giving the lessee for a term of years the right to mine and operate for oil and gas is not a sale of the oil and gas in place and the lessee has no vested interest therein until it is discovered, but when found, the right to produce becomes a vested right, and when extracted the title vests in the lessee and the consideration for royalty paid for the privilege of search and production is returned for the leased premises."

The reason for this rule of law is evident when it is considered that gas is of a migratory and fugitive character. It may be under one man's land today and under another man's land tomorrow. Unless it is reduced to possession it is not the plaintiff's property but the property of the lessor.

If the plaintiff desires to value the character of the property which it owns, it must value these leaseholds and not the estimated content which underlies the acreage to which these leases apply.

The fugitive character of gas in the ground is shown in Suttle v. Hoke Natural Gas Company, 82 W. Va. 729, 738, 97 S. E. 433, where the court says:

"Until reduced to possession by confinement natural gas, it is said, though somewhat inaccurately, partakes of the nature of ferae naturae. It is not the subject of ownership until brought to the surface and confined."

See also Wood County Petroleum Company v. West Virginia Transportation Company, 28 W. Va. 210, and Hall v. Vernon, 47 W. Va. 295.

In the former of these two cases the court held that natural gas is incapable of being absolute property and is the subject of qualified property only. This is the settled law in West Virginia and other states:

Smith v. Root, 66 W. Va. 633;

Toothman v. Courtney, 62 W. Va. 167;

Steelsmith v. Gartlow, 45 W. Va. 27;

City of Erie v. Public Service Commission, 278 Pa. 512;

Pennsylvania v. West Virginia, 262 U. S. 553 at Page 586.

We understand the rule in the Federal courts is that such decisions involving the rights of property

"constitute rules of property and must be accepted and applied in passing upon complainant's rights" (Guffey v. Smith, 237 U. S. 101).

From these decisions it is clear that the plaintiff in this case does not own the gas underneath the leases which it holds and that it merely possesses the right to explore for gas and to extract such gas if it finds it.

For all practical purposes the valuation witnesses of the plaintiff, especially Mr. Uebelacker and Mr. Davis, directed their attention to the ascertainment of the value of the gas content underlying the leases which it possesses, but if the plaintiff does not own this gas certainly the consumers of the gas cannot be asked to pay a return on its value.

Plaintiff by its argument would lead the court to believe that the distinction between the ownership of a right to explore for and the absolute ownership of title to the gas is not controlling in this case, and that it has little bearing on the question of value. That this is not true can be practically demonstrated without trespassing too much upon the time of the court.

If the plaintiff owned the gas in fee it would have to pay annually taxes thereon, but in the State of West Virginia where these leases are for the most part located, these taxes are paid by the lessor. On the other hand, the lessee is obligated to pay annually very large sums in the form of delay rentals, leasehold expenses and royalties. If the plaintiff owned the gas under the ground and not the right to explore for the same, it would not be required to pay these heavy annual charges. Protestants are unable to understand the

contention that these large annual payments have no bearing on the valuation of the right to explore for gas as distinguished from the valuation of the absolute ownership of the gas. The record shows that the rentals and the leasehold expenses from June, 1909, to December 31, 1923, have amounted to $7,126,454.33. (Jirgal Exhibit No. 3, R. 1436) exclusive of royalties. The royalties during the same period amounted to $1,691,455.63. In the year 1923 the record shows the payment for the former of these items was $589,186 (Jirgal Exhibit No. 3, R. 1436) and the royalties in the same year amounted to $192,246.76 (Jirgal Exhibit No. 5, R. 1469). The court will readily see that these large payments cannot help but influence the value to be placed upon the right to explore for gas as distinguished from the property right in the gas itself.

There is still another objection to placing a value on the leaseholds on the basis of the estimated gas content underlying the same. Practically all of the plaintiff's witnesses applied to the estimated gas content what they assumed to be the fair market value of gas at the mouth of the well or in the ground. Now, it is fundamental that the market value of any given commodity assumes its reduction to possession, or in other words its delivery to the purchaser. If gas is worth 35 cents per M. cubic feet in the Pittsburgh market, it is only worth that amount if delivery is made at that point. In other words, to make gas worth 35 cents per M. cubic feet there must be delivery by the seller to the purchaser. If gas is worth 10 cents per M. cubic feet at the mouth of the well it is only worth that amount when it has been lifted from its position underneath the ground to the

mouth of the well and delivered to the party who is to pay the 10 cents per unit received. Any article may be worth a certain fair market value if as soon as the purchaser pays for the same he receives the article. A man may be willing to pay $500.00 for an automobile, which another party owns at a distant location, on his representations that he does own it and that it is in a certain condition, but he will not pay that price until the seller has delivered the automobile and until he has seen its condition. In other words, the fair market value in this transaction is not established until the purchaser has reduced the automobile to possession and until he has satisfied himself as to the seller's representations.

The plaintiff in this case, however, in effect asks the consumers to pay on a valuation determined by applying a market price per unit to a commodity which has not been reduced to possession and which it cannot prove will ever be reduced to possession. In fact, it is known to begin with, that there are certain inherent qualities in the commodity itself which cast serious doubts upon plaintiff's ability to reduce same to possession.

The simple question before the court is whether the right to explore for and extract gas is as valuable as the gas itself. Would not a purchaser of the right to explore for gas discount very considerably in purchasing such right for the uncertainty as to whether the gas was actually underneath the ground to which the right inhered.

That there is a legal distinction between the right to explore and the ownership of the gas itself is indicated by the following:

> "The value of gas lands for rate making purposes is not the sale price of a cubic foot of gas as applied to the supposed quantity in a given field, but the reasonable known value of the whole tract or tracts from which the gas is produced." (American Indian Oil & Gas Company of Poteau (Okla.) 235, p. 906, P. U. R. 1926 A. 236, citing City of Erie v. Public Service Commission, 278, Pa. 512, 123 A. T. L. 471, P. U. R. 1924 D. 89.)

That a distinction is of considerable moment in this case may be gathered from the fact that the company in the proven area was in 1923 paying from $150 to $500 per well. Each well is assumed to drain about 100 acres so that the bonus cost of reproducing acreage in 1923 in the proven territory was $1.50 to $5.00 per acre. Plaintiff, through its witnesses, shows that there are 136,385 acres in what is termed the proven territory and 126,208 acres in the probable territory, making a total of 262,592 acres, to which is given a value of from $30,000,000 to $45,000,000, or a per acre value of from about $120 to $175 per acre. As will presently appear, protestants claim that the cost of reproducing the acreage on a bonus payment plan, which is the plan in use in acquiring this acreage, is about $3,000,000, or about $12.00 per acre.

Protestants contend that the only evidence in the record on the value of the right to explore for and extract gas is the book cost of the leases, and that the

value of the gas rights on this basis is not greater than $6,732,920.

THAT THE TESTIMONY OF PLAINTIFF'S WITNESS, EVEN IF IT WERE PERTINENT TO THE VALUATION QUESTION AT ISSUE, WAS BASED ON FACTORS WHICH HAD NO FOUNDATION IN FACT.

Plaintiff relied upon three sources of testimony to prove the value of the gas rights. There is one line of testimony by its witness Davis, another by its witness Uebelacker, and a third line of evidence by what are herein termed practical gas men. The character of evidence on the part of each of these witnesses is outlined below:

Mr. Davis first made his geological study and determined that under leases, which he classed as in proven territory, there was 249.1 billion cubic feet of gas, and that under leases in territory, which he classed as probable, there were 414.6 billion cubic feet of gas. The total gas content of his proven and probable territory was therefore 663.7 billion cubic feet of gas. It should be noted that there is almost twice as much gas in the probable territory as in the proven, and if a uniform market value per M. cubic feet is applied to this gas content, the valuation of the probable territory is almost twice the valuation for the proven territory. In other words, the speculative territory carries the same per unit valuation as the proven territory. Mr. Davis assumes that the plaintiff can divest itself on its public service responsibilities in Kentucky, West Vir-

ginia, and at other points and sell this gas wherever it chooses, the hypothetical market being Pittsburgh, where he assumes that the price of 35 cents per M. cubic feet can be secured from the steel mills. He thinks that this 35 cents per M. cubic feet can be obtained because producer gas manufactured from soft coal would, when related to natural gas on a heating value basis, sell in line with this price.

He next estimates the cost of transporting gas from Cedarville, W. Va., to Pittsburgh and finds that this cost will reduce the 35 cents to 27.99 cents per M. He then spreads the consumption of the gas content over the next 18 years, introducing into his statement at the same time some allowance for the purchase of gas from outside parties. His next step is to deduct from the value of the gas at Cedarville (27.99 cents) the assumed cost in each of the 18 years of producing and transporting the gas to Cedarville. The result of this deduction is to give him the net earnings per unit in each of the 18 years which will be derived from a thousand cubic feet of gas. He applies this unit of net earnings to the assumed sales each year and arrives at net income of $91,792,894 which is realized from the sale of 674.7 billion cubic feet of gas. The next step is to reduce this sum to present worth by applying a compound discount factor, and he also deducts Federal income taxes. His resulting value is $52,181,538.17. In order to deliver this gas to Cedarville, it is necessary to have certain physical property. In recognizing this fact Mr. Davis deducts $19,723,409 as representing the depreciated value of this property. After making this deduction, which he claims to be the market value of

the natural gas fee and leasehold property, the result is, he claims, a value of $32,458,129.17. All of this evidence on the part of Mr. Davis is shown in his Exhibit Z. (W. Va. Record 959-982.)

Mr. Uebelacker made a more direct valuation of the acreage by taking the following steps:

(1) He assumed the amount of recoverable gas which Mr. Davis estimated, to be correct. He has used instead of 663.7 billion cubic feet the sum of 663,108,431 M. cubic feet.

(2) He made an endeavor to ascertain the prevailing market price for gas and to deduct from this prevailing market price the cost of producing the same, and in some cases of transporting the same. By deducting this cost from the prevailing market price, he was able to ascertain what he contended was the value of the gas in the ground. This value was placed at 5 cents per thousand cubic feet.

(3) He applied this 5 cents to the 663,108,431 thousand cubic feet of gas and arrived at a valuation of $33,155,421.55. This valuation covered only proven and probable territory, and Mr. Uebelacker assumed a certain amount of the "wildcat" territory was necessary to the company's business (552,319 acres) and he valued this particular acreage at $5.96, which he supposed was the 1923 cost of acquiring this acreage, or a total for the wildcat acreage of $3,293,754. The total value for the acreage was, therefore, $36,-

449,754.00. (All of this evidence is given under Uebelacker's Exhibit No. 1, R. 995.)

Plaintiff introduced three witnesses who gave their opinion as to value of Plaintiff's gas rights, not as a result of a technical investigation but from the standpoint of practical oil and gas men. Each of these gentlemen was interested in gas development companies operating properties similar to those of the plaintiff. Mr. Sullivan, Mr. Corrin, and Mr. Gregory were each connected wih companies operating fields very near to plaintiff's leaseholds and either buy gas from or sell gas to the plaintiff. Their valuation estimates ranging from $30,000,000 to $45,000,000 were all arrived at on the basis of present exchange or market value of the gas in regulated markets. There is no evidence of any nearby markets capable of absorbing plaintiff's gas in the quantities now being produced. *No gas purchasing company is suggested other than public utilities subject to public service regulation.*

With the above explanation the court has before it the main factors on which plaintiff relies in its claim for appreciation of leases over and above book cost. Two factors are common to the valuations of Mr. Uebelacker and Mr. Davis, one being the estimated gas content of the leaseholds, and the other being that an assumed fair market price is applied to this gas content.

Protestants contend that the gas content cannot be accurately determined because the plaintiff only has a leasehold right and these leaseholds must be renewed from time to time and the plaintiff may not be able to

make renewals in a number of cases when the present leases expire. Protestants further claim that, even if all the leases can be renewed, there is no certainty that the adjoining prospector may not drain the gas by drilling his own wells.

There is a further doubt cast upon the gas content even in the proven territory, because Boyle's Law is of comparatively recent origin. (Davis, R. 833) It does not take into consideration the possibility of encroachment by surrounding water (R. 837-838) a contingency not to be disregarded in territory not yet drilled. Mr. Davis himself admits that the Internal Revenue Department has reduced these very estimates for proven territory 10%. (R. 832-833)

Even Boyle's law cannot apply to the entire proven territory, as the record shows that only about 69,000 acres have been drilled and Boyle's law cannot be applied except where wells are in existence so that the rock pressure can be determined. In view of the fact that there are 136,000 acres in proven territory, there is a considerable speculation as to even the gas in the proven territory.

When it comes to probable territory, the speculation becomes so marked as to bring into immediate question the propriety of valuing this territory at all. Mr. Davis himself (at R. 1179) says of this probable territory:

> "The estimation of gas reserves of territory which has been classed as probable territory is *naturally a difficult and uncertain undertaking*. Here we are dealing with ter-

ritory which is believed, from a careful study of all pertinent facts, to be gas territory, yet had it been sufficiently drilled to prove the correctness of this conclusion it would be proven territory. *Estimates made therefore of the probable territory, must be considered as much less trustworthy as those made of the proven territory.*"

With all of this uncertainty the plaintiff asks the consumers to pay substantially two-thirds of the value of its gas rights for these probable acreages.

The uncertainty attached to the valuation of probable territory has been recognized by the U. S. Internal Revenue Department. When determining the allowance for depletion in the case of income taxation, the rule of the Internal Revenue Department is that only proven territory shall be considered in determining discovery value. This rule is cited below:

"A proven area for the purposes of this statute shall be presumed to be that portion of the productive sand or zone or reservoir included in a square surface area of 160 acres having as its center the mouth of a well producing oil and or gas in commercial quantities. In other words, a producing well shall be presumed to prove that portion of a given sand zone or reservoir which is included in an area of 160 acres of land, regardless of boundaries. The center of such square area shall be the mouth of the well, and its side shall be parallel to the section lines established by the United States system of public land surveys in the district in which it is located. Where a district is not covered by the United States land sur-

veys the sides of said area shall run north and south, east and west."

Paragraph 2 of Article 220 (a) Regulations 62.

Mr. Davis attempts to apply this department regulation to areas which the department itself does not recognize as susceptible of valuation. Indeed, he admits that even as to proven territory the Internal Revenue Department has reduced his estimates ten per cent. (R. 833.)

With all of these factors of uncertainty in the gas content protestants claim that it is clear that no valuation can be assigned at all to the probable territory and that even the valuation of the proven territory must be discounted to a considerable extent.

The second point common to Mr. Davis and Mr. Uebelacker is that each applies what he assumes is a fair market value to the gas either at the point of market or at the point of production. As already shown, Mr. Davis assigns a market price of 27.99 cents per M. cubic feet for gas delivered at Cedarville. Mr. Uebelacker shows in his Exhibit No. 1, R. 995, that it costs 17.552 cents per M. cubic feet to produce gas and deliver it from the field to Cedarville, so that if 35 cents per M. cubic feet is a fair price at Pittsburgh and 27.99 cents is a fair price at Cedarville, and 17.552 cents is a fair cost to deliver the gas to Cedarville, then the value of the gas in the ground at the point of production must be 10.438 cents. Now Mr. Uebelacker has made a study which he considers exhaustive of the value of gas in the ground and he finds that this value is only 5 cents per M. cubic feet, and yet

with this marked discrepancy as to the price of gas in the ground, Mr. Uebelacker gets a value for the gas content of $33,155,421.00, while Mr. Davis with only one-half the value for gas in the ground assesses at a value for the leases of $32,458,129.00.

The court by analyzing the evidence of these witnesses will find that the reason for this difference is that Mr. Davis used too high a fair market price by 5 cents per M. cubic feet and that Mr. Uebelacker did not apply the correct principle in not reducing his fair market price for gas distributed over the next 18 years to present worth by the application of a compound discount factor. Mr. Davis correctly applied this factor but used too high a price. Mr. Uebelacker used a price which was more nearly right but did not apply any factor to reduce his future expected income to present worth. Therefore, each of these two witnesses made an erroneous deduction which in the final outcome was compensating, but which gave too high a valuation for the acreage. It will be presently shown that even 5 cents per M. cubic feet is too high for gas in the ground, but protestants will content themselves here by noting merely the discrepancies between the witnesses on estimates of the fair price for gas at the point of production.

Mr. Uebelacker in establishing his fair market price for gas in the ground accepted six contracts which he said were representative of such fair market value. These contracts are set forth in his Exhibit No. 1 R. 995. He deducts from the contract price under these six agreements the estimated production cost. He uses not production cost of the seller of the

gas under these contracts, but the production costs of the plaintiff. Protestants contend that it is the cost of the seller which determines his price and not the cost of the plaintiff. The seller may have very much higher costs than the plaintiff and he may be satisfied with a much lower margin of profit in setting his contract price. However, three of Mr. Uebelacker's contracts are of no use whatsoever in this case. We refer to the International Nickel Company contract, the deliveries to the Hope Natural Gas Company and the deliveries at Pittsburgh. The International Nickel Company has its gas delivered to it at Huntington at the price of 20 cents per M. cubic feet, while the plaintiff in the Huntington market delivers gas for 21 cents and yet claims that it is not getting a fair price for gas in West Virginia in general, and Huntington in particular. Plaintiff cannot justify a rate increase in West Virginia upon the alleged value of its gas in the ground, because such alleged value is predicated upon the selling price which is less than that permitted the plaintiff under existing rates. Plaintiff is claiming that his property is being confiscated in West Virginia and yet it tries to prove a value for its gas rights on the basis of a contract price to the International Nickel Company which is less than its own price in the same market.

The price at Pittsburgh is not fair because the market is too far removed. The price to the Hope Natural Gas Company and the Pittsburgh and West Virginia Gas Company is not fair because these are public utilities and can recoup the price which they pay from the consumers which they serve.

We have, therefore, only three representative contracts which show a value for gas in the ground feet. (R. 389) If the lifting cost estimated by Mr.

Owens Bottle Works	4.569 cents
So. Penn Oil Company	2.569 cents
Fall Rock Cannal Coal Co.	3.069 cents

That these are fair prices is shown by protestants' evidence in the record. For instance, the record shows that the plaintiff in 1923 purchased over nine billion cubic feet of gas, or about 20% of its requirements, at an average price of 6.4 cents per M. cubic feet. (R. 389) If the lifting cost estimated by Mr. Uebelacker of 5.4 cents per M. cubic feet is deducted from this average price the value of the gas in the ground becomes 1 cent per M. cubic feet.

Witness Jirgal (R. 883), testified to the execution of nine separate contracts in 1922, 1923 and 1924, calling for a price at the mouth of the well of from 7 to 8½ cents per M. cubic feet. Deducting again the lifting cost of Mr. Uebelacker, the value of gas in the ground becomes 1.6 cents to 3.1 cents per M. cubic feet. In the case of a number of these contracts Mr. Jirgal notes that the plaintiff has the right to extract gasoline.

It will be noted that all of these evidences of fair market value of gas in the ground obtain for deliveries in the production field of the plaintiff. They do not call for deliveries to far away regulated markets. They are the result of competition between producers in the producing field of the plaintiff and therefore they must be given the greatest weight in determin-

ing the fair market price for gas in the ground. The protestants therefore have submitted evidence to show Mr. Uebelacker's estimate of the fair market value of gas in the ground is too high and should be not greater than 3 cents per M. cubic feet. If the full gas content estimated by the plaintiff is assumed to be correct, a fact which protestants deny, the fair market value applied would be still incorrect. It is on such evidence as the foregoing that protestants before the District Court disputed the valuation amounts of Mr. Davis and Mr. Uebelacker. The plaintiff did not at any point in the record show that the protestants' evidence as to fair market price was inaccurate or incorrect, and therefore it would have been entitled to great weight before the District Court if that court had felt that evidence on the value of gas content was competent evidence.

It requires merely a mathematical demonstration, therefore, to apply the factors already mentioned in correction of the valuations of Mr. Davis and Mr. Uebelacker.

It will be recalled that Mr. Davis' estimate of fair market value was shown to be at least 5 cents per M. cubic feet too high if Mr. Uebelacker's determination of fair market value was correct. The court might well question why the protestants do not reduce Mr. Davis' estimate of fair market price 2 cents additional because of the contention that the fair market price is 3 cents per M. cubic feet. The reason this is not done is because Mr. Davis in his estimates assumes increasing costs for producing and delivering

gas, which absorb the extra 2 cents per M. cubic feet. Mr. Davis' estimate should be corrected as follows:

Average Net Value per M. cubic feet on basis of $91,792,894.00 Income to be realized before amortization from sales of 674.7 billion cubic feet during years, 1924-1941, inclusive in cents	13.605c
Deduct—Excessive market value shown to have been used by Mr. Davis	5.00
Average Net Value after Adjustment	8.605c
Expected Net Income before Amortization on basis of average net income of 8.605 cents per M. cubic feet to be realized from sales of 674.7 billion cubic feet	$58,057,887.77
Compound Discount Factor necessary to Convert to Present Worth	61.64%
Present Worth of above expected Net Income	35,787,927.21
12½% of Earnings, Income Tax ($58,057,887.77—$35,787,927.21)	2,783,745.07
Market Value of Gas Content	$33,004,182.14
Deduct—Depreciated Value of Property included other than natural gas fee and leasehold property necessary to deliver gas to market	19,723,409.00
Market Value of Natural Gas Fee and Leasehold Property	$13,280,773.14

Instead of the valuation of $32,458,129, Mr. Davis should have arrived at a valuation of $13,280,-

773.00. This still leaves open the question as to whether plaintiff can raise to the surface of the ground all of the gas content estimated by Mr. Davis. If it cannot the valuation should be still further reduced.

It will be recalled by the court that protestants exceptions to Mr. Uebelacker's valuation is that he used too high a value for gas in the ground and that he did not reduce to present worth the future expected income which would be derived from the sale of gas over the next 18 years. Instead of using 5 cents per M. cubic feet, Mr. Uebelacker should have used 3 cents per M. cubic feet. He should then have applied a compound discount factor to reduce to present worth his future expected income. In addition to this, the record shows that instead of using $5.96 per acre for the wildcat territory, he should have used 83 cents per acre for this territory. (See Jirgal Exhibit No. 3, R. 1436).

If Mr. Uebelacker's valuation is corrected in accordance with the above he should have arrived at a value of only $12,718,621 as indicated by the statement below:

663 billion cubic feet at 3 cents	$19,890,000
Present worth of a future expected income of 3 cents per M. cubic feet (Davis factor of 61.64%—See Judge Rose R. 1260) of West Virginia record in West Virginia Case	12,260,196
Add: Leasehold cost of 552,319 wildcat acres at bonus cost for 1923, or 83 cents per acre—Jirgal R. 1101	458,425
Uebelacker's Valuation after making proper adjustments	$12,718,621

The court will readily see that as to witnesses Davis and Uebelacker the testimony was not uncontradicted as claimed by plaintiff in its brief, but was on the contrary contradicted at every point. This contradiction took the form of a special memorandum on the part of protestants' witness Hagenah, Exhibits 2, 3 and 4, and the testimony of Mr. Jirgal, especially his Exhibits No. 3 and 4.

VALUATION ESTIMATES OF "PRACTICAL GAS MEN"

We come now to the testimony of the "practical" gas men who gave it as their opinion that the gas rights were worth $30,000,000 to $45,000,000. The court should bear in mind that none of these witnesses made any detailed calculations to support their conclusions. Any practical man who desired to purchase the gas rights of the plaintiff would certainly have a detailed report made thereon with numerous calculations supporting the final opinion as to value which was reached. This is the common business way of handling a situation of this kind. A man desiring to purchase gas rights would have geologists and valuation experts go over the territory and submit a number of reports to him, which reports would be the basis for a conclusion on his part as to value.

It is significant that none of these practical witnesses were able to give arithmetical demonstrations to the various factors considered by them as having weight in the final determination as to the total value assumed by them to be reasonable.

We call the court's attention to the fact that Mr. Davis and Mr. Uebelacker gave valuations were approximately the same amounts as these opinion experts and we have already shown the court that the valutions of these two witnesses were incomplete, inaccurate and excessive. If the District Court felt that evidence of this kind was competent, it would certainly discount the valuation of these opinion experts by the amount by which it found that the witnesses who made arithmetical demonstrations were incorrect. It has already been shown that Mr. Davis' and Mr. Uebelacker's valuations were excessive by about $20,000,000, and since they had to consider the same factors as the opinion experts their valuations should be reduced similarly.

It can be presently demonstrated that if Mr. Uebelacker's estimate of fair market value is incorrect, or if protestants' fair market value of gas in the ground is correct, the opinion experts' valuation must be incorrect. It will be recalled that most of these experts gave valuations around $35,000,000. If it can be shown that this valuation results in a fair market price for gas in the ground in excess of Mr. Uebelacker's estimates and in excess of the fair market value established by protestants, the valuations of these opinion experts must fall. We give such a demonstration in the following table:

Amount of Income over 18 years necessary to pay 8% on Investment of $35,000.00 and amortize such investment (Arrived at by applying factor of 61.64% indicated by Davis' table at R. 978)—See Judge Rose's decision in West Virginia case, R. 1260, of West Virginia record		$56,574,630
Federal Income Tax of 12½% (1923 rate) on difference between above amount and $35,000,000 capital to be depleted		2,696,829
Total above Items		$59,271,459
Average income per M. cubic feet necessary to pay above charges on basis of 663 billion cubic feet content for acreage (in cents)		8.939
Lifting costs computed by Mr. Uebelacker (R.)		5.431
Cost of gas above the ground		14.370
If Leasehold rentals and expenses are to be paid by the owner of the leases instead of the rate payers there will be added ($589,186 divided by 1923 consumption of 46 billion cu. ft.)		1.300
Cost of gas on this basis		15.670

It will be noted that a value of gas in the ground of 8.939 cents per M. cubic feet would be necessary to support a price of $35,000,000 for the acreage and

that a price at the mouth of the well of 15.670 would be necessary to sustain such valuation. Now the evidence already shows that the value of gas in the ground is only 5 cents per M. cubic feet according to Mr. Uebelacker and not in excess of 3 cents per M. cubic feet as shown by the protestants. The value of gas at the mouth of the well is shown by Mr. Uebelacker to be 8 to 10 cents per M. cubic feet in the producing field, and by protestants to be 7 to 8½ cents. A fair price of over 15 cents is therefore out of the question.

In seeking the reason for this evident overvaluation, we find that two of the opinion witnesses at least (Mr. Sullivan and Mr. Gregory) took into consideration that the producing fields were already connected with the ultimate market which they propose to supply if they purchase the gas rights. Mr. Sullivan has the following to say on this point (W. Va. Case No. 79):

> " * * * that he had in mind such market in the states of Ohio and Pennsylvania, through gas lines which are *already installed*, and *some of which are already connected;* that he believed there is a sufficiently large market through pipe lines easily reached to market all the product of the United Fuel Gas Company if it could be secured for that market * * * "

Mr. Gregory states (W. Va. Case No. 79):

> " * * * that the territory served by the Manufacturers' Light and Heat Company in the distribution and sale of natural gas, is principally in Ohio and Pennsylvania; all the Ohio river towns from Pennsylvania south

to New Martinsville, West Virginia, on both sides of the river; Newcastle, Pennsylvania, and the Pittsburgh district; that connection could be gotten to reach through Indiana without building any other lines; that all this gas could be diverted from Buffalo, N. Y., to Erie, Pennsylvania through existing lines * * * * *"

These experts should have determined the value of the leases as if no transportation facilities were already in existence. That this is a very important factor in their valuation in indicated by the fact that Mr. Davis finds that the depreciated value of the transportation property necessary to handle the gas to Cedarville is about $9,000,000 and Mr. Uebelacker shows that it would take nearly $11,000,000 to transport the gas from Cedarville to Pittsburgh. It would require, therefore, practically a transporting system of the value of $20,000,000 to transport the gas from the field to the Pittsburgh market, which is one of the markets these opinion experts would supply.

This large transporting investment certainly cannot be taken into consideration by these opinion experts in valuing the leases.

The apparent purpose of introducing Mr. Sullivan, Mr. Corrin and Mr. Gregory, was to attempt to establish a valuation of the leaseholds not based upon their gas content. It will appear from their testimony, however, that practically every one of them had some personal knowledge of the amount of gas which Mr. Davis estimated was in the ground.

These men were all associated with gas development companies and professed to be familiar with the

price of gas lands in the market. Their positions in the gas industry were such, however, as peculiarly to affect their estimates of the value of the property of the United Fuel Gas Company. Mr. Sullivan and Mr. Corrin were each vice presidents and executive officers of the Hope Natural Gas Company (R. 780, 785). Mr. Gregory was president of the Manufacturers' Heat & Light Company. The Hope Company is a large purchaser from the plaintiff. In 1923 it purchased 4,416,000 M. cubic feet. The Manufacturers' Heat & Light Company in turn buys from the Hope (Gregory, R. 791). In addition, both of these companies operate large gas fields in West Virginia, and the Hope, in particular, has extended its production system into territory adjacent to that of the plaintiff. Both companies are public utilities selling natural gas to domestic consumers at regulated prices. It is by no means difficult to see what the natural disposition of each of the gentlemen naturally would be as to the value of the commodity in the production and marketing of which they are so vitally interested.

The values assigned by these witnesses to the gas rights of the plaintiff, can be justified only because they can resell such gas to their present consumers located at far away points, at a substantial profit.

It is a matter of common knowledge in the natural gas field that the farther the distribution systems are from the point of gas production, the higher the price which can be secured in the ultimate market. This is true because as the supply of gas becomes less and less, the markets which are farthest away are the first which must abandon the use of natural gas.

The secret of these excessive estimates lies in the fact that the basis of the judgment of every one of these witnesses was the present tremendous earning power of the plaintiff in existing public utility markets. The very nature of their business experience and the situations of the plaintiff and of the companies in which the witnesses were interested in the public utility business were all such as to render it a practical impossibility for them to dissociate the market value of gas from its value in the only business in which all of the companies in question are engaged. Mr. Sullivan (R. 780), Mr. Corrin (R. 785) and Mr. Gregory (R. 791) attempt to say that their estimates relate to value in an unregulated market. Reference to their various statements as to the factors considered by them demonstrates, however, that it was only the public utility demand and the earnings of the plaintiff in the public utility market which directly or indirectly gave the value to plaintiff's property concerning which they were testifying. Any other market existed only in speculation. That this is true is best supported by the record of their testimony, from which the following statements are illustrative:

> "That by the fair value of the gas property he means that he thinks that the proven territory and the possible territory adjacent to the proven territory is worth that amount as a producing field for a gas company, considering what it could obtain for the gas, and the knowledge that he has of the operations and of the field enables him to put that value on it, excluding the wells themselves; that the gas could be sold, in his opinion, for such an amount as would give to those properties that value; that the cost

of carrying the leases was not considered by him and is not an element in his estimate; that the price of gas considered by him in fixing his value upon said property was the price said gas is selling for in the market today" (Corrin, R. 788).

"That he saw the engineer's figures as to the amount of gas which would likely come out of the property, 663-billion cubic feet, but that his valuation wasn't based entirely on that" (Corrin, R. 786).

"That he had information as to the acreage, number of wells, amount of gas produced and sold from this territory during the last ten years, 'the selection of the acreage with reference to the possibility of marketing the gas, the marketing the gas in Pennsylvania and Ohio, the general demand for gas in those states and after considering all these varying different items he arrived at the value which he gave to the gas territory.'

"That in his opinion the value of the gas reserves for natural gas purposes alone of the United Fuel Gas Company is in round figures $34,000,000; that that is what he considers a prudent purchaser who desired to buy the property ought to be willing to pay to a willing seller therefor" (Sullivan, R. 781).

"That his valuation was put 'upon the has put upon the leaseholds of the gas reserves of United Fuel Gas Company are based largely upon the market for natural gas in Pittsburgh and in other territory adjacent thereto" (Gregory, R. 792).

"That his valuation was put 'upon the theory that there was at a certain point and in a certain territory a demand for gas and that by reason of that demand or the necessities of the public utility that desired the gas they would be willing to pay certain prices in order to get it and the value of the property is determined largely by the rate at which you are able to sell the gas' " (Gregory, R. 793).

It is manifest from the foregoing quotations that the value concerning which these witnesses spoke was a value induced by the demands and necessities of the public utility market. This is not inferentially, but expressly, shown by the statements of Gregory (R. 791) and as by Corrin (R. 785-6).

In the case of Natural Gas Company of West Virginia v. Public Service Commission, 95 W. Va., 557, 568, the State Supreme Court treated testimony similar to that presented here as follows:

"There are two objections to his testimony that we deem material. The first is that, while he may have been qualified as an expert witness, he does not sufficiently define the open market for these leaseholds. The burden in this case is upon the company to establish its right to an increase. Section 9, ch. 15-0, Barnes' Code, 1923. The mere statement of the witness that the leaseholds are worth so much in the open market is not enough; he should have pointed out that market, defined it and explained its character. Of course, if a natural gas public utility were the proposed purchaser, evidence of its offer would not be competent to show fair value in a rate case; and in like manner evidence of

one whose valuation is based upon what he could obtain for the property when offered to a public utility would be incompetent; or if it is based upon the rate of return at the time of the offer or upon anticipated returns from the public it should be rejected. Generally speaking, evidence of value in a rate-making case cannot be based upon the rate of return or earnings of the utility; and whenever this appears, either directly or indirectly, such evidence is incompetent. It is almost inconceivable that there could be an open market for these gas leaseholds, situated as they are, which would not be based upon the rate at which the utilities there are selling gas to the public. While we held in City of Charleston v. Public Service Commission, 95 W. Va. 91, 120 S. E. 398, that in a rate case a utility is entitled to include in its present fair value as a rate base, appreciation in the value of its leaseholds over investment cost, yet the evidence must not be based upon, but must be independent of the rates of return or earnings. Since the burden of showing the necessity or fairness of the proposed increase in rates is upon the company, a like burden is imposed upon it to show the value of its leaseholds over investment cost, as their value forms a component part of the rate base upon which the return is calculated. We hold, therefore, that a mere statement that they have a certain value in the open market is not sufficient; the party desiring to establish such value must by proper testimony show that it is independent of the rate of return or earnings of the company. Guided by this rule, the evidence in this respect is insufficient."

No doubt it was to meet just such criticism as the court there expressed that certain of the witnesses, despite the very obvious tenor of their whole testimony, attempted to say that in arriving at their estimates of value they had "in mind" an unregulated market, probably in Indiana, Ohio, the New York commercial market, or in the Pittsburgh industrial district. (R. 782, 788, 791). Truly these markets exist in the "mind." Of all the many conjectures upon which the different elements of plaintiff's case are founded none is more speculative than this undefined and unexplained market for plaintiff's gas supply, bounded on the east by some point in the state of New York, on the west by Indiana, and in all this wide domain theoretically free from embarrassing interference by the regulatory bodies of those states. All of these demands are to be supplied by the plaintiff, corporations created and existing under the public utility laws of the State of West Virginia (United Fuel Gas Company), and Kentucky (Warfield Natural Gas Company), which companies have enjoyed the benefits of those laws since their organization. It involves the false theory of founding value upon earning, the "vicious circle" so frequently discredited by the courts.

Plaintiff devotes a portion of its brief to the proposition that "there was an entire absence of any contradicting testimony" on the matter of the valuation of the gas rights.

This statement is not supported by the record. Mr. Hagenah's Exhibits Nos. 2, 3 and 4 (R. 1521-1548) deny the accuracy of the estimates of plaintiff's witnesses and their methods of valuation. Mr. Jirgal's

testimony and exhibits, especially his Exhibit No. 4, which shows the average cost of gas purchased, tend to refute Uebelacker's estimates of the value of the gas in the ground. The criticisms of both of these witnesses have been reflected in many parts of this brief.

Were plaintiff's proposition wholly true, however, it would not have the bearing which is attempted to be ascribed to it here. Opinions of witnesses as to such illusory matters are not analogous to testimony of observed facts which is usually accepted unless denied. Opinions on such questions need not be accepted by the Court. The Conqueror, 166 U. S. 110; Wilcox v. Consolidated Gas Co., 212 U. S. 19.

> "Where factor in determination of whether electric rates amount to taking of company's property without just compensation involves prophecy, or rests on opinion evidence, neither commission or court is bound to accept absolutely either of conflicting views or opinion of single expert where but one testifies" (Decided April 28, 1927).
>
> Idaho Power Co. v. Thompson, 19 Fed. (2d) 547.

It is difficult to conceive a case where this principle has stronger application than to opinions as to the value of gas not yet discovered, and which if ever marketed must be sold over a long period of years.

Plaintiff in its brief here, as in the District Court, has charged the protestants with failure to produce practical gas men to contradict the testimony of those

examined by the plaintiff. The reason is obvious. All such experienced and practical sellers of gas are interested in securing the highest possible price for it; they are directly interested in securing an increase in rates for the plaintiff because this will result in an increase in the value of their product—hence no such witnesses were available to the protestants.

From a consideration of plaintiff's evidence we think that the following propositions relating to the valuation of plaintiff's gas rights are established:

1. That as the plaintiff has only a leasehold title or license as distinguished from a fee title or ownership, the leases must be valued as such and the amount of gas underneath such leases does not determine their value.

2. That gas being of a migratory and fugitive character, its presence underground cannot be considered in valuing leaseholds unless and until it is reduced to possesion, or unless all uncertainties as to its being reduced to possesion are removed.

3. That assumed markets for gas far distant from the location of plaintiff's property furnish no proper basis upon which to establish the fair values of leasehold rights.

4. That the price of a substitute product furnishes no basis upon which to establish the value of a property which has been dedicated to the public use.

5. That a public utility market for plaintiff's gas cannot be considered in de-

termining the value of its gas rights, for the reason that the public utility in that market has its rates regulated and the cost of the gas which it purchases from the plaintiff will control the rates which it is entitled to charge.

6. That in view of the nature of plaintiff's so-called leases, where the consumers pay the cost of carrying such leases as part of plaintiff's operating expense, they cannot be required to pay a return upon more than their actual cost.

7. That if plaintiff should be allowed to capitalize any increase in value of any part of its leases, the plaintiff and not the consumers must pay the carrying charges thereof.

8. The valuation of gas rights must be uninfluenced by the fact that the field of the plaintiff is already connected with far away markets, because to consider such connection amounts to including in the leasehold valuation all or part of the cost of the necessary transportation system.

PROPER MEASURE OF APPRECIATED VALUE OF PLAINTIFF'S GAS RIGHTS

The Protestants contend that if this Court be of opinion that the District Court should have considered plaintiff's evidence of appreciation of its leaseholds, and that such appreciated value should be reflected in the rate base, the amount thereof should be ascertained by the application of one or the other of the following methods:

(1) Ascertain from the evidence the

present day bonus cost of reproduction of the leases and add to such bonus cost of reproduction the present day carrying charges for the reasonable period found necessary to assemble all of these leases, and other expenses of assembling the leases. This method will give the best evidence of the cost of reproducing plaintiff's gas rights.

(2) Substitute in the operating expenses for the year 1923, the fair market price of the gas in the ground used in that year, and eliminate from such operating expenses any items which relate to the carrying costs of the acreage and from the rate base any items relating to its value.

(3) If the Court considers that the fair market value of gas in the ground has been established, only the value of the gas in the proven acreage can be included in the rate base.

(4) If the Court be of opinion to consider both "proven" and "probable" acreage, then it is necessary to ascertain what portion of this gas content valuation is presently used and useful.

(1)—COST OF REPRODUCING LEASEHOLDS:

Mr. Jirgal's testimony (R. 865) shows the bonus cost of reproducing the acreage in the principal producing fields during the years 1921 to 1924, inclusive. By the application of these bonus costs to the total acreage leased by the company, a fair determination can be made of the cost of reproducing by the bonus payment plan the present acreage. In reproducing acreage considerable time would be required to assemble the various tracts and there would, therefore, necessarily be incurred considerable amounts for rentals and for

leasehold expenses. This method of valuation affords evidence of the cost of reproducing that kind of property which the plaintiff actually owns, that is, leasehold rights to explore for gas. The cost of reproduction of the acreage on this basis would not be in excess of three million dollars ($3,000,000). This is shown by the following table based on "Jirgal Ex. No. 3":

District	County	Total Acreage	Bonus Cost of Reproduction Per Acre	Bonus Cost of Reproduction
Union	Clay	16,481.38	$2.50	$ 41,203.45
Washington	Jackson	16,388.80	1.00	16,388.80
Cabin Creek	Kanawha	42,501.85	1.00	42,501.85
Big Sandy	Kanawha	46,775.32	4.50	210,488.94
Elk	Kanawha	26,149.64	1.75	45,761.87
Warfield	Mingo	9,050.87	1.00	9,050.87
Curtis	Roane	15,795.87	1.30	20,534.63
Geary	Roane	51,320.99	5.00	256,604.95
Smithfield	Roane	23,725.02	2.90	68,502.56
Spencer	Roane	14,717.60	1.00	14,717.60
Walton	Roane	23,159.52	5.00	115,797.60
Kentucky		109,786.25	.10	10,978.63
All others		408,573.97	.25	102,143.49
Total		804,427.08	$1.18	$954,675.24

Assuming that it would take three years to acquire the total acreage owned by the company, there should be added—three times the delayed rental charges for 1923 (R. 1436)	$1,885,570.47
Three times the leasehold expenses for 1923 (R. 1436)	146,105.85
Total cost of reproduction as of December 31, 1923	$2,986,351.56

The value of the leaseholds, obtained by this method, is lower than the book cost for the reason that in placing the original valuation on these leases, the plaintiff disregarded the then costs of reproducing the leases or any cost of renewing the leases at that particular time. The Board of Directors merely valued the leases on a basis which would support the capitalization of the company.

(2)—GAS PURCHASED THEORY:

Judge Rose in the West Virginia cases, which are being heard by this Court at the same time as this case, suggested that all controversy as to the value of the leasehold could be eliminated, if in the year 1923 for instance, the gas actually reduced to possession from plaintiff's leases could be valued at the then ascertained fair market value per M. cubic feet. In order to apply this theory all operating expenses relating to the leases would be eliminated and cost of the gas priced at fair market value would be substituted. The total fair value of the property would be exclusive of the leasehold values. Mr. Hagenah applied this principle (Judge Rose evidently overlooked this fact) by including in the operating expenses 5 cents per M. cubic feet for all gas taken out of plaintiff's territory in 1923. For this purpose Mr. Uebelacker's value of 5 cents for gas in the ground was accepted but it was assumed to cover the value of gasoline extraction because contracts, signed in 1922, 1923 and 1924, supported this interpretation.

Classes of Business	Cost of Reproduction Less Depreciation at Dec. 31, 1923**	Net Earnings Available for Depreciation and Return	Depreciation 4.5 Per Cent of Book Cost of Property	Net Earnings Available for Return	Per Cent on Cost of Reproduction Less Depreciation
West Virginia:					
Charleston	$ 3,396,534	$ 651,356	$ 132,957*	$ 518,399	15.26
Huntington	2,556,555	275,830	101,034*	174,796	6.84***
Williamson	349,858	44,434	13,822*	30,612	8.75
Other West Virginia Towns	1,831,021	314,116	71,525*	242,591	13.25
Total West Virginia	$ 8,133,968	$1,285,736	$ 319,338*	$ 966,398	11.88
Kentucky	2,716,778	666,572	106,786*	559,786	20.60
Ohio	1,616,574	344,756	63,799*	280,957	17.38
Wholesale Service	15,491,860	3,120,116	607,084*	2,513,032	16.22
Total Gas Department	$27,959,180	$5,417,180	$1,097,007*	$4,320,173	15.45

* Red.

** Covers Mr. Hagenah's value of physical property, going concern value and working capital, in fact all elements of value except leaseholds.

*** Comparatively low return at Huntington is due to competition at Huntington hereinafter explained.

On this basis Kentucky retail business shows an earning capacity of 20.60 per cent on cost new less depreciation for physical property, working capital and going concern value. This is, of course, much in excess of a reasonable return of 8%. The court should also note that the Kentucky retail business pays the highest return of any class of business carried on by plaintiff.

(3)—ONLY "PROVEN" ACREAGE TO BE CONSIDERED:

We submit that there can be no just claim by the plaintiff that it has been unfairly dealt with if the future supply of gas estimated to be in the "proven" territory is valued at the alleged 1923 fair market value in the ground of all such gas.

As stated, the Income Tax Department of the government has confined its determinations of discovery value in the case of natural gas deposits to "proven" territory defined in such way as practically to include what Mr. Davis has classed as proven territory for the purposes of this case. The District Court found that this proven territory was sufficient at the present rate of consumption to take care of plaintiff's entire business for five years in the future and to provide for its retail business in the state of West Virginia for over 20 years.

The record shows that the company purchased in 1923 over 9 billion cubic feet of gas from outside parties and that it drew from its own territory only 37 billion cubic feet. If this rate of purchase from

outside parties is maintained at the rate obtaining for 1923, the gas supply in the proven territory would last nearly 7 years. All of the uncertainties as to whether this gas can be reduced to possession are of course not removed and the plaintiff is, therefore, being fairly dealt with if the Court should apply to the content in the proven acreage the fair market value of gas in the ground. Protestants claim that this fair market value is shown to be about 3 cents per thousand cubic feet, while plaintiff urges a value of 5 cents per thousand cubic feet. On these two bases the valuation of the gas in the proven territory (663.7 billion cubic feet) would be as follows:

At 5 cents per thousand cubic feet	$12,455,000.00
At 3 cents per thousand cubic feet	7,473,000.00

Protestants contend that this method is far too favorable to the plaintiff because it does not consider the fact that the gas has not actually been reduced to possession. The consumer, therefore, will still speculate on the possibility as to whether the plaintiff will actually be able to raise the gas to the surface of the well.

(4)—PART OF PLAINTIFF'S GAS RESERVE PRESENTLY USED AND USEFUL:

The solution of the valuation question outlined in the foregoing paragraph has added significance when it is considered in connection with Mr. Hagenah's estimate of the portion of plaintiff's gas rights presently used and useful in the utility business. His Exhibit No. 5 (R. 1555) is a masterly application of that principle to plaintiff's gas rights. As an engineer

it is his belief that "the public interest will be adequately protected by a reserve sufficient to meet all reasonable requirements for 5 years in the future, and only such portion of the reserve should be included in the rate base at its fair present value." We ask the court's consideration of his diagram picturing the relation of this five-year supply to the entire reserve found at p. 1556 of the Record and explained at p. 923.

At the present rate of production this method of valuation would closely approximate the value of the gas content of the proven territory as estimated by Mr. Davis, $10,317,311.39. For that reason, seemingly, it was this valuation of the proven territory which received the apparent approval of Judge Rose in the West Virginia case presently being heard by this court:

> "For the reasons already stated, we cannot see how any other portion of its gas can be held to be used in the public service, no matter how elastic a definition be given to the word 'used.' At the risk of tiresome repetition, we can say that we do not criticize plaintiff for acquiring any or all its gas rights. It was doubtless wise to get them. All that we decide is that in arriving at the rate base upon which plaintiff is entitled to a fair return, we may not combine two opposing theories. We are not justified in saying that because plaintiff's investments in gas reserves were prudent, those reserves immediately went into use and that therefore plaintiff is entitled to have them appraised at the many times higher value it says they now have. If in dealing with its tangible property and going concern value, we are

required to ignore, except for check purposes, plaintiff's investment in them, we must apply the same rule to its gas services.

> "If we are right $10,317,311.39 is the highest valuation which can be put upon such portion of plaintiff's reserves as it has any claim to include in its rate base."

United Fuel Gas Company v. Public Service Commission of West Virginia, et al., 14 Fed. 209.

Plaintiff emphasizes the vision and foresight of its officers in assembling its large lease holdings, and the consequent advantage to the public. Protestants submit that there is little advantage to the public if it is to pay a return on the entire gas reserve of the plaintiff, part of which may not be used for many years. Mr. Hagenah forcibly pointed this out as follows:

> "Where does the public gain in the slightest degree by the company going out and buying this gas land in the future if it must always pay for it on the basis of its gained value as determined by competitive conditions by the exchange method. The public would gain by the fact that it had the gas, but it would pay a price for it purely determined by the monopoly power."

On the basis of Mr. Hagenah's calculations, the value of the gas reserves (based on $33,000,000 valuation of Mr. Uebelacker) by the two methods explained by him are as follows:

Using 5/18 of the appraised value and 13/18 of the book cost	$14,005,554
Using only 5/18 of the appraised value	9,166,667

This limiting of capitalizing appreciation of gas reserves to only such part thereof as is presently used and useful is sustained by the City of Erie case, cited and relied on by plaintiff, where the Supreme Court of Pennsylvania held:

> "Gas holdings should be included and valued for rate-fixing purposes only to the extent that they represent developed, used, and useful territory, including a reasonable reserve for the continued functioning of the company in the public service."
>
> City of Erie v. P. S. C., 228 Pa. 512; 132 Atl. 471, 478 (Syl. 11).

If this Court feels that plaintiff's evidence was competent to show the amount of appreciation which had taken place in the leaseholds over and above their book cost, there would still be open the question as to what the fair value of such leaseholds should be for the purpose of adjusting rates to the consumers. The protestants claim that the character of the testimony offered by the plaintiff is not such as to be admissible in a consideration of the fair value of the leaseholds. If the Court be of the mind, however, that some measure of appreciation has been shown, it must certainly reach the conclusion that the extent of such appreciation is in no sense measured by the claims in connection therewith made by the plaintiff. It has already been shown in this breif that even if the principle of valuing gas content is correct, the results obtained by plaintiff's witnesses under this principle were highly excessive and not supported by the other evidence introduced in the record. In order that the Court may have before it some information on which to measure

the extent of appreciation, if any, which it may feel has been established by the plaintiff, there is summarized below what protestants claim is the best evidence thereon:

(1) The book cost of the acreage has been shown at R. 1430 and 1510 to be (Jirgal shows that if the $589,-186 of delay rentals and leasehold expenses are allowed to remain in operating expenses, the plaintiff is in effect allowed a return of 8% on $7,360,000 additional, so that on this theory, the effective valuation of the leaseholds becomes over $14,000,000. See Jirgal Exhibit No. 3. Jirgal further shows in his exhibit that the $6,732,920 does not represent the cost of the leases to the corporation, but rather an appraised value made by the Board of Directors at the time of acquisition. The company's records show that there is at least two million dollars' worth of inflation in this amount. Jirgal Exhibit No. 3, R. 1426.)	$ 6,732,920
(2) Cost of reproducing leases on basis of prevailing bonus payments, lease rentals, etc, in 1923 is shown on page [illegible] hereof to be	$ 3,000,000
(3) The value of gas in the proven territory at 5 cents	

per thousand cubic feet (Uebelacker's fair market price) would be $12,455,000

(4) The value of gas in the proven territory at 3 cents per thousand cubic feet (protestants' fair market value) would be ..... $ 7,473,000

(5) If the acreage is valued on the basis of taking 5/18 of the appreciated value of $33,000,000 and 13/18 of the book cost of $6,700,000, the presently used and useful property would be valued at $14,005,554

If the presently used and useful property be valued at 5/18 of the total appreciated value of $33,000,000, the value of the acreage would be ..... $ 9,166,667

If the book costs of the leases are appreciated on the same basis as the general increase in price of other commodities (Hagenah, R. 485, Case No. 79) the value would be ..... $ 9,495,920

If Mr. Davis' valuation is properly corrected so as to make it consistent with Mr. Uebelacker's Pittsburgh price of 30 cents, or for the undisputed fact that the value of gas in the ground at the point of production is only 5 cents per thousand cubic feet, he would arrive at a value of $13,280,773

If Mr. Uebelacker's valuation is properly corrected in order to

take into consideration that the fair market value of gas in the ground is 3 cents instead of 5 cents and if his future expected income from the sale of gas is reduced to present worth, and if the assumed reproduction cost of his wildcat acres is properly adjusted, his valuation would become $12,718,621

If the practical gas men had been forced to compute arithmetically on the basis of the prevailing field price for gas, the value of the acreage on which they expressed an opinion, and if these practical gas men had not taken into consideration the fact that the field was already connected, they could not have arrived at a value much in excess of Mr. Davis and Mr. Uebelacker, and the highest value they could probably give would be ..... $15,000,000 to $20,000,000

It appears to the protestants that the question before this Court is, therefore, whether, when all this evidence is weighed, there could be a finding for the value of the leaseholds in excess of $10,500,000. Commissioner Divine of the Public Service Commission of West Virginia arrived at this value for the acreage, after considering all of plaintiff's evidence on appreciation. Judge Rose, in reviewing that case, indicated that in his opinion, the value of the leaseholds was not in excess of $10,317,311.39. Protestants claim that

the plaintiff would be better off to accept Judge Hickenlooper's finding of $6,732,920 as the value of the leaseholds, because in so doing, there would continue to remain in the operating expenses $589,186 which, when capitalized at 8 per cent and added to the foregoing value of the acreage, would give a value therefor of over $14,000,000. This Court, even if it should conclude that the evidence on appreciation should have been considered, would, protestants are sure, not be inclined to disturb a finding of $10,500,000 for these leases.

PHYSICAL PROPERTY

The evidence on the value of the physical property, that is, the property consisting of the wells, transmission pipe lines, distribution pipe lines, office buildings, etc., was as follows:

Cost of Reproduction New less Depreciation — As submitted by Mr. Uebelacker, representing the plaintiff	$28,631,320
As submitted by Mr. Hagenah, representing the protestants	23,969,180
Historical Cost as submitted by Mr. Uebelacker, for the plaintiff	25,090,788
Book cost as submitted by Mr. Jirgal, for the protestants	19,945,582

The protestants in the West Virginia Cases before the District Court for the Southern District of West Virginia filed an exhibit showing that the reproduction

cost which would be arrived at, were price index numbers applied to the book costs, would be $24,546,309.

Judge Hickenlooper arrived at a value of $26,283,844 by accepting Mr. Uebelacker's cost of reproduction less depreciation, but excluding overheads, and adding to this amount an allowance of 18 per cent for the overhead charges as testified to by Mr. Hagenah.

As already indicated, the same evidence was presented before the Public Service Commission of West Virginia and the District Court for the Southern District of West Virginia as was submitted to Judge Hickenlooper. In the Public Service Commission Case, Commissioner Stathers found a value of $25,000,000 for the physical property, Commissioner Divine found a value of $26,000,000, and the District Court, in reviewing the case, stated that in its opinion, the physical property did not have a value in excess of $26,000,000.

In accepting Mr. Uebelacker's estimate of reproduction cost less depreciation, Judge Hickenlooper subscribed to the theory of observed depreciation except in the case of the depletion of wells.

The question with respect to the valuation of the physical property are not difficult of settlement. They may be briefly stated as follows:

> (1) In determining the amount of accrued depreciation which is to be deducted from reproduction cost in determining the cost of reproduction new less depreciation, should the observed depreciation method be used in a case where the property is being

exhausted because of the limited supply of gas?

(2) In applying overheads to cost of reproduction new less depreciation, should cost of financing be included and should a 7 or 8 per cent rate for interest during construction be applied?

(3) When a determination has been made as to the cost of reproduction new less depreciation, need the District Court have determined the fair value at this amount, or could it have considered other evidence on value, such as book cost, historical cost, etc.?

On the matter of estimating accrued depreciation, this Court has merely to decide whether the rule laid down in Pacific Gas & Electric Company v. City and County of San Francisco, 265 U. S. 403, and McCardle v. Indianapolis Water Company, 272, U. S. 400, applies to this case. We have here a property which is being exhausted through use. Even the plaintiff estimates that on the basis of the assumed gas content, the property will be exhausted in eighteen years. It would appear clear that a thing has a lesser value if its life is limited, than it would have if its life were not limited. Protestants do not state that the observed depreciation rule would not be applicable in the case of a perpetual utility such as an electric light plant or an artificial gas plant, but they do contend that the rule does not apply to the portion of plaintiff's property which has a definite life, and will not be renewed at the end of that definite life. Mr. Hagenah applied the amortization principle to that portion of the property, the life of which would be ended with the exhaustion of

the field, and applied the observation method, the same as Mr. Uebelacker, to that portion of the property which would be useful after the exhaustion of the fields.

If Judge Hickenlooper had taken the view of the protestants in this case on the matter of accrued depreciation, he would have arrived at the value for the physical property estimated by Mr. Hagenah at $23,969,180, or roundly, $24,000,000. This is true because he accepted the percentage for overheads used by Mr. Hagenah and, as already noted, the accrued depreciation and the overhead questions are the only ones in dispute in determining the value of the physical property.

On the question of overheads, the matter is equally simple. Mr. Uebelacker, in his Exhibit No. 1, R. 995, shows that he applied in the case of general overheads, 21½ per cent to the specific cost of the production system, 26 per cent to the specific cost of the transmission system, 22 per cent in the case of the distribution system, and 22 per cent in the case of general property. As a part of these overheads, he applied uniformly 4 per cent for cost of financing and 8 per cent for interest during construction. Judge Hickenlooper rightly decided that the item of cost of financing should have been eliminated and that 7 per cent was a liberal allowance for interest during construction. If these two adjustments are made to Mr. Uebelackers estimates, 18 per cent will cover the remaining items of overhead contended for by plaintiffs. The matter of financing expense was covered by Jirgal in his testimony at R. 882, where he stated that it was in the same category as discount, in that it was to be deducted from the par

value of the securities in order to arrive at the amount which the plaintiff would secure through the sale of such securities. Mr. Jirgal did not state, as pointed out in plaintiff's brief, that this was bond discount, but merely stated that it should be treated the same as bond discount. We think that this Court's opinion in Galveston Electric Company v. Galveston, 258 U. S. 388 is decidedly in point, as it covers exactly the same item. This Court in that case, held as follows:

> "The other item included by the master in determining base value, but disallowed by the court, is $67,078 for brokerage fees. There is no evidence that any sum was in fact paid as brokerage, and there was included, as above shown, the sum of $73,281 for organization and business management in calculating the historical reproduction cost. The finding of the master rests upon testimony that bankers customarily get, in some form, compensation equal to 4 per cent on the money procured by them for such enterprises. But compensation for broker's services is often paid in the lessened price at which they take the company's securities, and is thus represented in the higher rate of interest or dividend paid on the money actually received by the company as capital. The reason given by the master for including the allowance for an assumed brokerage fee is that a brokerage fee is a 'normal incident of large industrial investments and has not been amortized,' since 'the record shows that the plant has been operated at a loss.' If base value were to be fixed by the money expended, brokerage fees actually paid might, with propriety, be included, as are taxes paid pending construc-

tion. But as the base value considered is the present value, that value must be measured by money; and the customary cost of obtaining the money is immaterial. We cannot say that the court erred in refusing to include in base value an allowance for hypothetical brokers' fees."

See also Volume I of Spurr on Guiding Principles of Public Utility Regulation, pages 468-469.

The District Court had before it the evidence of Mr. Hagenah to the effect that 7 per cent was a reasonable charge for interest during construction, and Mr. Uebelacker's testimony to the effect that 8 per cent was necessary. The Court had an opportunity to weigh all the testimony given and had a right both because of precedent and because of the application of this item to the present case, to decide on 7 per cent as against 8 per cent. In the following cases, allowances for interest during construction ranging from 3 to 7 per cent were approved:

State Journal Prtg. Co. v. Madison G. & El. Co., 4 Wis. R. C. 501;

Re: Mountain States Tel. & Tel. Co. (Colo.) P. U. R. 1917 B 198;

Re: Mountain States Tel. & Tel. Co. (Idaho) P. U. R. 1921 B 738;

Columbia v. Watts Eng. Co. (Mo.) P. U. R. 1915 B 921;

Re: Petoluma & S. R. R. (Cal.) P. U. R. 1915 B 742;

Re: San Francisco-Oakland Term. Ry. (Cal.) P. U. R. 1915 D 44;

Metropolitan Trust Co. v. Houston & T. C. R. Co., 90 Fed. 683;

Re: Public Service R. Co. (N. J.) P. U. R. 1921 D 593.

Even if Mr. Uebelacker's estimate of cost of reproduction less depreciation had been accepted by the District Court without adjustment, it would still have been proper to arrive at a value of $26,283,844. The Court had before it not only this evidence of value, but the historical cost submitted by Mr. Uebelacker and the book cost submitted by Mr. Jirgal. Jirgal's Exhibit No. 6 shows that a considerable portion of the company's physical property has been built in periods of high prices. This Court has repeatedly held that the term "fair value" is not synonymous with "cost of reproduction less depreciation." It has also held that there need be no slavish adherence to the cost of reproduction principle or to any one evidence of value. Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U. S. 679; Georgia Railway & Power Co. v. Railroad Commission, 262 U. S. 625; Minnesota Rate Cases, 230 U. S. 352; Smyth v. Ames, 169 U. S. 466; Kings County Lighting Co. v. Prendergast, 7 Fed. (2d) 192; Brooklyn Union Gas Co. v. Prendergast, 7 Fed. (2d) 412, 432.

We do not think that the District Court, even if it had conceded Mr. Uebelacker's valuation as being correct, could have arrived at a higher value for the physical property than it did, provided that there was a proper weighing of the other evidence on value.

The protestants contend that the district court should have used Mr. Hagenah's principle of determining accrued depreciation, and that 18 per cent is shown to be ample for overhead items. On this basis the physical property could only have been found to have a value of $24,000,000.

WORKING CAPITAL

The working capital allowances of $990,000.00 is said by Mr. Uebelacker to include the amount shown on the company's books for materials and supplies on hand at December 31, 1923, and a reasonable allowance for cash in bank, together with two month's average operating expenses based upon the year ending December 31, 1923. Mr. Hagenah accepted this allowance as reasonable and it accordingly was adopted by the Commission and the Court.

GOING CONCERN VALUE

Plaintiff's bill does not challenge the Commission's allowance of $3,000,000.00 for going concern value. No assignment of error mentions it. A reasonable presumption, therefore, would be that plaintiff acquiesced in this finding of the Commission.

Mr. Uebelacker made no calculation of the going value, as "such value cannot be arithmetically computed" (Uebelacker Ex. No. 1, R. 995). Nevertheless, he did not mean to imply that such value was nonexistent, nor that an allowance should not be included therefor. Since in his opinion the plant was in a state of 100 per cent working efficiency, and was a going concern with customers attached, as contrasted with

a dead plant, he considered the cost of reproduction new without any deduction for deterioration to be the correct measure of the value of the plant. Thus he completely absorbs the $8,423,105.00, his estimate of accrued deterioration, in a blanket allowance for going concern value. If it were really true that the difficulty of estimating and computing depreciation could be thus easily eliminated, there would be much to commend Mr. Uebelacker's theory of going value. However, an old plant does not have and cannot be adjudged to have value equal to that of the same plant and equipment new. Whatever of value the "going" business and the attached patronage may add to the concern, no sound reason can be advanced for identifying it with the accrued depreciation. The latter is neither measure nor guide of the former.

Mr. Hagenah recognized "going concern" as an element of value, and as a result of his analysis of many similar cases and a study of plaintiff's business and properties, fixed $3,000,000.00 as a fair allowance therefor (R. 910). As stated above, this figure was approved by the West Virginia Commission and the District Court. Judge Hickenlooper deemed this allowance extremely generous under the facts of this case, referring especially to the liberal overhead allowances.

> "The expert called for the protesting municipalities (Hagenah) has conceded the propriety of including an item of $3,000,000.00 as "going concern" value in arriving at the present fair value of the complainant's properties. Although not contested we are not able to join wholeheartedly in this

concession. There are cases in which the plant as entirety has a value greater than the value of the component parts, but such value is difficult of computation, most uncertain in amount, and generally is the outgrowth of the expenses incident to assembling in one unit all the various parts which go to make up the whole. These expenses have received consideration in estimating overhead expenses during and prior to construction. So also, the items of property have been valued as integral parts of the new operating whole, and as already charged with the attendant values as such, as well as with construction overheads. In addition to this, general overhead charges of every conceivable kind have been included. Thus, as direct or construction overheads added to the labor portion of unit costs in valuation we find insurance, loss and use of tools, field supervision, timekeeping, and contingencies, and as part of the overhead, added to cost of material, purchasing, warehousing, and contingencies. In addition to these we find other general overheads added for engineering and superintendence, administration, interest, preconstruction costs, legal expenses, insurance and taxes, and cost of financing.

"It is extremely difficult to conceive of any other elements which might go into the property to increase its value as an entirety over the aggregate of component parts, and we must not, in the name of going concern value, sanction the inclusion of mere good will as predicated upon earning capacity. This position is well expressed by the Supreme Court of Iowa in Cedar Rapids Gas Co. v. Cedar Rapids, 144 Iowa 426, 120 N. W. 966, 48 L. R. A. (N. S.) 1025, 138 Am.

St. Rep. 299, 223 U. S. 655, 32 Sup. Ct. 389, 56 L. Ed. 594; * * * As previously intimated, the value of the plant is to be estimated in its entirety, rather than by the addition of estimates on its component parts, though the latter course will materially aid in determining the value. * * * Save as above indicated, the element of value designated as 'going concern' is but another name for 'good will' which is not to be taken into account in a case like this. * * * This language was cited with approval in DesMoines Gas Co. v. DesMoines, 238 U. S. 153, 35 Sup. Ct. 811, 59 L. Ed. 1244, in which the Supreme Court approved the disallowance of a 'going concern' value.

"The evidence does not satisfactorily distinguish between that going concern value claimed and good will, and in so far as we admit such item in the valuation we are of the opinion that it must be held to include all the disputed overhead charges. Certainly we could not include a going concern value in excess of the $3,000,000.00 conceded. Mr. Uebelacker originally included no allowance whatever for this item and his estimate of a going concern value of $8,423,111.00 is wholly without reason or evidential support."

CONCLUSIONS AS TO FAIR VALUE OF TOTAL PROPERTY

The protestants take the position that the holdings of Judge Hickenlooper as to each element of property are such that no confiscation appears. On the question of leaseholds, we believe that the Court will find that there is no competent evidence to show any ap-

preciation over book cost. On the question of physical property, we are quite sure that the Court will find that Judge Hickenlooper was too liberal to the plaintiff, and that $24,000,000 was a finding amply justified by the record. There is no dispute on the necessary amount for working capital, and Judge Hickenlooper properly held that there was no evidentiary support for the claim of plaintiff for going value in the amount of $8,423,105.

If the Court is of a mind that some appreciation had been proved by the plaintiff, we are quite sure that $10,500,000 would cover this item. If this appreciation is allowed for, the maximum fair value shown by the record would be as follows:

Physical Property	$24,000,000
Working Capital	990,000
Going Concern Value	3,000,000
Total Above	$27,990,000
Leasehold Value not to Exceed	10,500,000
Total Fair Value for Property	$38,490,000

It has already been shown that 9.72 per cent of the total for physical property, working capital and going concern value, should be assigned to the Kentucky retail business on a scientific apportionment basis. It has also been shown that 6.97 per cent of the production property, including leaseholds, should be assigned to this business. It is an easy mathematical proposition to compute the fair value of the property assignable to the Kentucky retail business by the

application of these percentages to the total shown above. This is done below:

Kentucky retail district's proportion (9.72%) of total physical property value, working capital, going concern value of $27,990,000	$ 2,720,628
Kentucky retail district's proportion (6.97%) of leasehold valuation of $10,500,000	731,850
Total Fair Value Assignable to Kentucky retail districts	$3,452,478*

*If Judge Hickenlooper's valuation of $26,283,844 is accepted for the physical property, this amount becomes roundly, $3,700,000.

The Court will probably be interested in having a comparison of the findings of the West Virginia Public Service Commission, the District Court for the Southern District of West Virginia and the District Court for the Eastern District of Kentucky. Such a comparison is given in the following statement:

Classification	District Court for Southern District of West Virginia (Judge Rose)	District Court for Eastern District of Kentucky (Judge Hickenlooper)	Public Service Commission of West Virginia	
			Chairman Stather's Opinion*	Commissioner Divine's Opinion
Physical Property	$26,283,844.00	$26,000,000.00	$25,648,457.72	$26,666,000.00
Working Capital	999,000.00**	990,000.00	990,000.00	999,000.00**
Going Concern Value	3,000,000.00	3,000,000.00	3,000,000.00	3,000,000.00
Leaseholds	6,732,920.00	10,317,311.39	6,361,511.42	10,500,000.00
Total	$37,015,764.00	$40,307,311.39	$35,999,969.14	$41,165,000.00

*Value stated as of December 31, 1923, was $35,333,329.67, but the Commission evidently considered 1924 plant additions in all its calculations (See R. 132-133 W. Va. Case No. 79).

**Evidently an error as all witnesses accept the figure of $990,000.00.

It will be noted that four different parties have considered the evidence of the plaintiff, and that none of these parties arrived at a value in excess of $41,000,000, and that two of these parties have decided that there was no evidence of appreciation in the leaseholds over book cost, while the other two parties, considering all of the evidence, could not arrive at a value for the leaseholds in excess of $10,500,000.

HYPOTHETICAL RATE BASE

Accepting the estimate of applicant's engineer as to the cost of reproduction new less depreciation ($28,631,320.00) and adding thereto the undisputed amount for working capital ($990,000.00) and also the only supported estimate of going concern value ($3,000,000.00) we have:

Physical Property	$28,631,320.00
Going Concern Value	3,000,000.00
Working Capital	990,000.00
Total	$32,621,320.00
Add to this the lowest valuation of the gas properties fixed by any of Appellant's witnesses in the gas business	$30,000,000.00
Total	$62,621,320.00
Instead of allocating to the Kentucky property 11% as set up by appellants there should be allocated to Kentucky physical property, going concern value, and working capital, taken as a whole, 9.72% on the amount fixed by Mr. Uebelacker	$ 3,171,122.00

And instead of taking 11% as the amount, the total that should be allocated to Kentucky on leaseholds there should only be taken the sum of 6.97%, sales basis, as properly assignable to Kentucky		$ 2,091,000.00
Total		$ 5,262,122.00
The witness, Jirgal (R. 1424), filed a table which shows after adjusting earnings only for the value of the gasoline extraction privilege that there is available for depletion, depreciation and return from the Kentucky business		$ 749,839.00
Amortization @ 4½% (on total less working capital)		$ 258,737.00
Return @ 8% (on total)		$ 420,969.00
Depreciation @ 1½% (on physical property)		$ 47,566.00
Total		$ 727,272.00
To produce the above percentage set by Mr. Uebelacker upon a hypothetical rate base of		$ 5,262,122.00
While according to Mr. Jirgal's calculations aforesaid there is		749,839.00

Leaving a surplus of or practically 3.1% more than a fair return.	22,567.00
If there is added thereto on a sale basis 6.97% of $589,186.00 delayed rentals and leasehold expenses for year 1923, we have the following	41,066.00
Amount in addition for a return or a total of $ in addition to the 8% return claimed.	63,633.00

CONCLUSION

The judgment (R. 1595-1596) of the lower Court should be affirmed for in the words of Judge Hickenlooper (R. 1588):

> "From what has been said the conclusion is inevitable that, if the rate base be fixed at $37,015,564.00 (the base adopted), and the rate sought to be enjoined be considered as 32 cents per 1,000 cubic feet, less such discount as the company may determine, the complainants have failed to sustain the burden which rests upon them of showing that such rate is confiscatory. Similarily, if the rate base be considered as appreciated by reason of the appraisement of the gas leases or acreage, and the rate of return reduced from 16 per cent plus, to that considered amply reasonable in the case of the ordinary

utility, say 8 or 9 per cent, the complainants have likewise failed to show confiscation."

Respectfully submitted,

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